



PHD

A comparison of British and German banking strategies in the context of European financial integration between 1993 and 2003

Janssen, Sven

Award date:
2007

Awarding institution:
University of Bath

[Link to publication](#)

Alternative formats

If you require this document in an alternative format, please contact:
openaccess@bath.ac.uk

Copyright of this thesis rests with the author. Access is subject to the above licence, if given. If no licence is specified above, original content in this thesis is licensed under the terms of the Creative Commons Attribution-NonCommercial 4.0 International (CC BY-NC-ND 4.0) Licence (<https://creativecommons.org/licenses/by-nc-nd/4.0/>). Any third-party copyright material present remains the property of its respective owner(s) and is licensed under its existing terms.

Take down policy

If you consider content within Bath's Research Portal to be in breach of UK law, please contact: openaccess@bath.ac.uk with the details. Your claim will be investigated and, where appropriate, the item will be removed from public view as soon as possible.

**A comparison of British and German banking strategies
in the context of European financial integration between
1993 and 2003**

Sven Janssen

A thesis submitted for the degree of Doctor of Philosophy

University of Bath

School of Management

July 2007

COPYRIGHT

Attention is drawn to the fact that copyright of this thesis rests with its author. This copy of the thesis has been supplied on condition that anyone who consults it is understood to recognise that its copyright rests with its author and that no quotation from the thesis and no information derived from it may be published without the prior written consent of the author.

This thesis may be made available for consultation within the University Library and may be photocopied or lent to other libraries for the purposes of consultation.

A handwritten signature in black ink, appearing to read 'Sven Janssen', with a long horizontal flourish extending to the right.

[Signature]

UMI Number: U601943

All rights reserved

INFORMATION TO ALL USERS

The quality of this reproduction is dependent upon the quality of the copy submitted.

In the unlikely event that the author did not send a complete manuscript and there are missing pages, these will be noted. Also, if material had to be removed, a note will indicate the deletion.



UMI U601943

Published by ProQuest LLC 2013. Copyright in the Dissertation held by the Author.
Microform Edition © ProQuest LLC.

All rights reserved. This work is protected against
unauthorized copying under Title 17, United States Code.



ProQuest LLC
789 East Eisenhower Parkway
P.O. Box 1346
Ann Arbor, MI 48106-1346

UNIVERSITY OF BATH
LIBRARY

10 - 7 JAN 2003

Ph.D.

ABSTRACT

The British and German financial systems constitute a significant part of the European financial system(s). Banks are important institutional pillars of any financial system. The largest British and German banks are therefore agents that determine the structure of these financial systems. By studying the corporate strategies of eight publicly listed banks, this research shows how and why British and German banks pursued entirely different strategies between 1993 and 2003. The banks researched are The Royal Bank of Scotland (RBS), HSBC, Barclays, Lloyds TSB in Britain and Deutsche Bank, Dresdner Bank, Commerzbank and HVB in Germany.

This two-country, longitudinal multiple case research argues that the beginning of the “completed” European Common Market in 1993, along with the global market liberalisation, disintermediation and rapid technological progress in the 1990s, provoked two fundamentally different strategic reactions by the banks. One took the form of a defensive strategy, whereby the bank remained focused on its domestic market. The other fully embraced all new opportunities and led to an international multi-business strategy. Yet, the attempt to capture all, or at least many, of the new opportunities deprived banks of their strategic focus. Effectively, neither of these corporate strategies promoted European financial integration to any significant degree.

There exists little work on the interdependence of micro and macro structures in the banking industry. This investigation aims to fill the gap which has emerged following ample research into the European banking sector as an aggregate and the few case studies of specific German and British banks. Evidence is provided that banks which pursued a defensive strategy and accepted the premise of a coherent national financial system fared better than those which attempted to break out of a coherent financial system in order to embrace new business opportunities which were not compatible with the prevailing system.

ACKNOWLEDGMENTS

The decision to do a PhD is, quite frankly, a rather selfish one, with consequences affecting far more people than just the researcher. At the beginning of this PhD project, just as now towards the end of it, was the desire to bridge my real world experience in banking by taking a more detached academic view. This thesis should lay the foundation for my future ambition of remaining committed to bridging things which appear unbridgeable. I would like to thank several people who in one way or another contributed to the completion of this thesis.

First and foremost my parents, Inge und Werner Janssen, who have always encouraged me to pursue my dreams and aspirations until they turn into wonderful memories. Without their love and support, this project would not have been possible. I would like to thank my supervisor Dr Alan Butt Philip, who was there on many occasions to share his rich human and academic wisdom with me. My thoughts also go to the late David Fairlamb, former financial correspondent of Businessweek, who would have loved to see this research completed.

I am indebted to many of my former colleagues from Bankhaus Metzler, affiliates of the Centre for Financial Studies at the Johann Wolfgang Goethe University in Frankfurt, clients in the fund management industry and the community of financial journalists in Frankfurt. During many discussions in different European financial centres, they contributed to this work and at times served as informal interviewees, sharing with me their insights into the European banking landscape. I also have to thank those who explicitly and consciously took time to talk to me about their professional experience.

Finally, I would like to thank the following people who all in their special and individual way were important for this thesis to come about: Roger Eatwell, Anne Thomas, Steffen Kern, Chris Barnes, Christiane Hocke, Sabine Brendel, Yuka Kawakami-Seljegard, Celia Lane, Janine Roeder. I am extremely grateful to those of my close friends who understood that I wanted to pursue this dream and therefore put up with my abruptness, occasional grumpiness and mood swings. Thank you.

CONTENTS

Abstract	3
Acknowledgements	5
Contents	7
List of Diagrams	13
Abbreviations	17
1. <u>The problem and the objective of this research</u>	19
2. <u>The playing field for banking strategies – EU financial integration</u>	25
2.1. Introduction	25
2.2. European financial system(s): between markets and institutions	28
2.2.1. Disintermediation within a financial system from a market perspective	
2.2.2. Pension reform and the implications for the financial system	
2.2.3. The role of the state in the financial system	
2.3. European financial markets – pooling liquidity	38
2.3.1. Money markets	
2.3.2. Bond markets	
2.3.3. Equity markets	
2.3.4. Retail markets	
2.4. What is a bank?	53
2.4.1. The rationale for banking regulation	
2.4.2. Legal definition of a bank in the European Union	
2.4.2.1. Treaty of Rome	
2.4.2.2. First Banking Directive (77/780/EEC)	
2.4.2.3. Second Banking Directive (89/646/EEC)	

2.4.2.4. <i>Financial Services Action Plan (COM(1999) 232)</i>	
2.4.3. Legal definition of a bank in the UK	
2.4.4. Legal definition of a bank in Germany	
2.4.5. Microeconomic definition of a bank	
2.4.6. Macroeconomic definition of a bank	
2.4.7. Mergers & acquisitions in banking – a macro-force	
2.5. Expectations at the outset of the European Common Market and concluding remarks on the benefits of integrating financial systems	81
3. <u>Corporate strategy analysis and applicability to the banking sector</u>	89
3.1. Introduction	89
3.2. Strategy analysis in its historical context	93
3.3. A multifaceted term: “strategy” as it is used in this research	101
3.3.1. Strategy as plan	
3.3.2. Strategy as pattern and structure	
3.3.3. Strategy as perspective	
3.3.4. Strategic positioning	
3.3.5. Strategy as ploy and tactic	
3.3.6. Between micro and macrostructure: “strategy” in this research	
3.4. Economic structures revisited – competitive forces in the banking industry	115
3.4.1. A framework for competition analysis	
3.4.2. Barriers to entry in banking	
3.4.3. Analysis of competition among established players in a banking market	
3.4.4. The substitution problem for banking products and services	
3.4.5. The bargaining power behind a bank’s asset-liability management	

3.5. A bank's resources determine its core competence	147
3.6. Banking: the link between micro- and macrostructures	153
4. <u>Research philosophy and methodology</u>	159
4.1. Introduction	159
4.2. The ontological perspective – bridging the micro/macro divide	163
4.3. Strategy and strategic management: an epistemological distinction	167
4.4. Case studies – a means of theory building	171
4.5. Triangulation	174
4.5.1. Accounting analysis	
4.5.1.1. <i>Income structure</i>	
4.5.1.2. <i>Cost and risk management</i>	
4.5.1.3. <i>Asset-liability structure</i>	
4.5.1.4. <i>Profitability</i>	
4.5.2. Archival research	
4.5.3. LexisNexis database survey	
4.6. A note on the author's background and concluding remarks	187
5. <u>British and German banking: case studies</u>	189
5.1. Introduction	189
<u>5.2. The Royal Bank of Scotland plc</u>	205
5.2.1. Introduction and Status Quo in 1993	
5.2.2. Income Structure	
5.2.2.1. <i>Structural Overview</i>	
5.2.2.2. <i>Corporate and Investment Banking</i>	
5.2.2.3. <i>Asset Management</i>	
5.2.2.4. <i>Retail Banking</i>	
5.2.3. Cost and Risk Management	
5.2.4. Asset-Liability Structure	
5.2.5. Profitability	

5.2.6. Conclusion

5.3. Deutsche Bank AG

233

5.3.1. Introduction and Status Quo in 1993

5.3.2. Income Structure

5.3.2.1. *Structural Overview*

5.3.2.2. *Corporate and Investment Banking*

5.3.2.3. *Asset Management*

5.3.2.4. *Retail Banking*

5.3.3. Cost and Risk Management

5.3.4. Asset-Liability Structure

5.3.5. Profitability

5.3.6. Conclusion

5.4. HSBC Holdings plc

260

5.4.1. Introduction and Status Quo in 1993

5.4.2. Income Structure

5.4.2.1. *Structural Overview*

5.4.2.2. *Corporate and Investment Banking*

5.4.2.3. *Asset Management*

5.4.2.4. *Retail Banking*

5.4.3. Cost and Risk Management

5.4.4. Asset-Liability Structure

5.4.5. Profitability

5.4.6. Conclusion

5.5. Commerzbank AG

287

5.5.1. Introduction and Status Quo in 1993

5.5.2. Income Structure

5.5.2.1. *Structural Overview*

5.5.2.2. *Corporate and Investment Banking*

5.5.2.3. *Asset Management*

5.5.2.4. *Retail Banking*

5.5.3. Cost and Risk Management

5.5.4. Asset-Liability Structure

5.5.5. Profitability

5.5.6. Conclusion

5.6. Barclays plc

314

5.6.1. Introduction and Status Quo in 1993

5.6.2. Income Structure

5.6.2.1. *Structural Overview*

5.6.2.2. *Corporate and Investment Banking*

5.6.2.3. *Asset Management*

5.6.2.4. *Retail Banking*

5.6.3. Cost and Risk Management

5.6.4. Asset-Liability Structure

5.6.5. Profitability

5.6.6. Conclusion

5.7. HVB Group AG / Bayerische Vereinsbank AG 342

5.7.1. Introduction and Status Quo in 1993

5.7.2. Income Structure

5.7.2.1. *Structural Overview*

5.7.2.2. *Corporate and Investment Banking*

5.7.2.3. *Asset Management*

5.7.2.4. *Retail Banking*

5.7.3. Cost and Risk Management

5.7.4. Asset-Liability Structure

5.7.5. Profitability

5.7.6. Conclusion

5.8. Lloyds TSB plc 375

5.8.1. Introduction and Status Quo in 1993

5.8.2. Income Structure

5.8.2.1. *Structural Overview*

5.8.2.2. *Corporate and Investment Banking*

5.8.2.3. *Asset Management*

5.8.2.4. *Retail Banking*

5.8.3. Cost and Risk Management

5.8.4. Asset-Liability Structure

5.8.5. Profitability

5.8.6. Conclusion

5.9. Dresdner Bank AG 401

5.9.1. Introduction and Status Quo in 1993

5.9.2. Income Structure

5.9.2.1. *Structural Overview*

5.9.2.2. *Corporate and Investment Banking*

5.9.2.3. *Asset Management*

5.9.2.4. *Retail Banking*

5.9.3. Cost and Risk Management

5.9.4. Asset-Liability Structure

5.9.5. Profitability

5.9.6. Conclusion

6. Conclusions 434

6.1. Introduction 434

**6.2. Discussion of the findings
from each case study 436**

6.3. Cross-case pattern analysis 444

**6.4. Bridging the micro/macro divide in European
economic integration 453**

**6.5. Methodological limitations and
suggestions for future research 464**

6.6. Epilogue – daring an outlook 466

Bibliography & Sources 469

A) Books

B) Journals and periodicals

**C) Publications by research institutes,
universities and think tanks**

**D) Articles from newspapers, magazines and
news agencies**

E) Publications by banks and companies

**F) Publications by governments, national and
international organisations**

G) Interviews, speeches and presentations

LIST OF DIAGRAMS

Porter's "Five Forces Framework"	117
Porter's model adapted to the banking sector	118
Banking Structure	130
Value-chain of an industrial firm	136
Value-chain of a bank	136
Longitudinal and cross-country comparison	160
Different Research Approaches: Triangulation	174
Real GDP-growth (1985-2005)	189
Inflation rates (1985-2005)	190
Unemployment rates (1985-2005)	192
Aggregate data on the British and German banking sector	199
RBS: income structure	208
RBS: net interest margin	210
RBS: total revenues per employee vs. personnel expenses per employee	221
RBS: cost to income ratio and loan loss provisions	222
RBS: NPL coverage	224
RBS: asset structure	226
RBS: liabilities and equity structure	227
RBS: return on equity	229
Deutsche Bank: income structure	235
Deutsche Bank: net interest margin	236
Deutsche Bank: total revenues per employee vs. personnel expenses per employee	248
Deutsche Bank: cost to income ratio and loan loss provisions	249
Deutsche Bank: NPL coverage	250
Deutsche Bank: liabilities and equity structure	253

Deutsche Bank: asset structure	254
Deutsche Bank: return on equity	255
HSBC Holdings: income structure	265
HSBC Holdings: net interest margin	266
HSBC Holdings: cost to income ratio and loan loss provisions	276
HSBC Holdings: total revenues per employee vs. personnel expenses per employee	278
HSBC Holdings: NPL coverage	279
HSBC Holdings: liabilities and equity structure	280
HSBC Holdings: asset structure	281
HSBC Holdings: return on equity	283
Commerzbank: income structure	291
Commerzbank: net interest margin	292
Commerzbank: total revenues per employee vs. personnel expenses per employee	303
Commerzbank: cost to income ratio and loan loss provisions	304
Commerzbank: NPL coverage	305
Commerzbank: asset structure	307
Commerzbank: liabilities and equity structure	308
Commerzbank: return on equity	310
Barclays: income structure	318
Barclays: net interest margin	319
Barclays: cost to income ratio and loan loss provisions	331
Barclays: total revenues per employee vs. personnel expenses per employee	332
Barclays: NPL coverage	333
Barclays: liabilities and equity structure	335
Barclays: asset structure	336

Barclays: return on equity	338
HVB Group: income structure	346
HVB Group: net interest margin	347
HVB Group: total revenues per employee vs. personnel expenses per employee	360
HVB Group: cost to income ratio and loan loss provisions	361
HVB Group: NPL coverage	363
HVB Group: asset structure	366
HVB Group: liabilities and equity structure	367
Comparison of average funding structures at Hypo-Bank and Vereinsbank between 1993 and 1997	368
Comparison of average asset structures at Hypo-Bank and Vereinsbank between 1993 and 1997	368
HVB Group: return on equity	370
Lloyds Bank/Lloyds TSB: income structure	378
Lloyds Bank/Lloyds TSB: net interest margin	379
Lloyds Bank/Lloyds TSB: cost to income ratio and loan loss provisions	389
Lloyds Bank/Lloyds TSB: total revenues per employee vs. personnel expenses per employee	390
Lloyds Bank/Lloyds TSB: NPL coverage	391
Lloyds Bank/Lloyds TSB: asset structure	394
Lloyds Bank/Lloyds TSB: liabilities and equity structure	395
Lloyds Bank/Lloyds TSB: return on equity	397
Dresdner Bank: income structure	406
Dresdner Bank: net interest margin	407
Dresdner Bank: cost to income ratio and loan loss provisions	420
Dresdner Bank: NPL coverage	421

Dresdner Bank: total revenues per employee vs. personnel expenses per employee	423
Dresdner Bank: liabilities and equity structure	427
Dresdner Bank: asset structure	428
Dresdner Bank: return on equity	431
Relative share price performance of British and German banks (1993-2003)	438
Total operating income growth (CAGR 1993-2003)	445
Cost to income ratio (average 1993-2003)	448
Net interest margin (average 1993-2003)	449
Loan loss provisions/net interest income (average 1993-2003)	450
Average income structure of analysed British banks (1993-2003)	451
Average income structure of analysed German banks (1993-2003)	451
Return on equity (1993-2003)	452
Comparison of ROEs	453
Tier 1 ratio (average 1993-2003)	455

ABBREVIATIONS

ATM	Automated Teller Machine
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Services Supervisory Agency)
BIS	Bank for International Settlements
CAD	Capital Adequacy Directive
CAGR	Compound annual growth rate
CAPM	Capital asset pricing model
CIR	Cost Income Ratio
EC	European Community
ECB	European Central Bank
ECSC	European Coal and Steel Community
EEC	European Economic Community
EFC	Economic and Financial Committee
EMU	European Monetary Union
EU	European Union
EVA	Economic Value Added
FAZ	Frankfurter Allgemeine Zeitung
FSA	Financial Services Authority (UK)
FSAP	Financial Services Action Plan
FT	Financial Times
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
HGB	Handelsgesetzbuch (German Commercial Code)
HHI	Herfindahl Hirschman Index
IAS	International Accounting Standards
IFA	Independent Financial Advisor
IMF	International Monetary Fund
ISA	Individual Savings Accounts
KWG	Kreditwesengesetz (German Banking Act)
LSE	London Stock Exchange
NPL	Non-performing loan

OECD	Organisation for Economic Cooperation and Development
OTC	Over-the-counter
PEPs	Personal equity plans
ROA	Return on Assets
ROE	Return on Equity
RWA	Risk Weighted Assets
SCP	Structure-conduct-performance
SEA	Single European Act
SEM	Single European Market
SIB	Securities and Investments Board
SMEs	Small-and-Medium Sized Enterprises
SMP	Single Market Programme
SRO	Self Regulatory Organisation
y-o-y	Year-on-year (comparison)

1. The problem and the objective of this research

The member states of the European Union created a Common Market in 1993, which also led to one of the world's financially most integrated regions. Deregulating the European banking market was one of the primary objectives of the Single European Act, which paved the way for the creation of the Common Market. A range of policy measures, foremost among them the Second Banking Directive, raised expectations that the Common Market would stimulate cross-border banking (Buch, 2000; Buch, 2001).

These expectations were fuelled by several research projects initiated by the European Commission. The first and most widely discussed was "Cost of Non-Europe", carried out under the auspices of Paolo Cecchini (Cecchini, 1988). Known as the Cecchini Report, it concluded that the Single Market Programme would have a major macroeconomic impact, increasing the EU's (at that time EC's) GDP by approximately 4.5% (Cecchini, 1988, p. 97). Of this potential incremental increase in GDP, 1.5% could be attributed to the liberalisation of financial services (Cecchini, 1988, p. 98). The Cecchini Report assumed that the European Common Market would trigger competitive forces in financial systems (Cecchini, 1988; Howells & Bain, 2002). However, more than a decade after the creation of the Common Market, European banking integration is far from having met the expectations raised by studies such as the Cecchini Report.

European banking integration has been extensively analysed on an aggregate level as part of macroeconomic research projects on the integration of European financial systems (Belaisch, 2001; Buch & Heinrich, 2002; Cabral et al., 2002; Dermine, 1996; Goddard et al., 2001; Schmidt et al., 1998; White, 1998). Conventional explanations identify high entry costs, the difficulty of realising transnational economies of scale and imperfect information as reasons why the European banking market remains fragmented and nationally segmented.

Despite these insights into the slowness of the integration process, there is little research about the interdependence between micro and macro structures in the banking industry. Therefore, this research approaches the

macroeconomic integration of the European banking sector through a microeconomic perspective, namely the study of realised banking strategies. In contrast to Cecchini's model, which primarily considered the opportunities of economic integration, it aims to show why large banks' strategic reactions to market liberalisation did not significantly contribute to financial integration.

A study commissioned by the European Financial Services Round Table, also known as the Gyllenhammar Report (prepared by F. Heinemann and M. Jopp in 2002), points out the need for an examination of individual banks and their strategies to complement the extensive analyses of aggregate data on the European banking sector, a view which is shared by Buch (Buch, 2001b), Giannetti (Giannetti, et al., 2002,) and Beckmann (Beckmann, et al., 2002).

This research studies major corporate developments at eight publicly listed banks in Britain and Germany between 1993 and 2003. Using a two-country, longitudinal multiple case study approach, it aims to fill the gap between the ample research into the European banking sector in aggregate and the few case studies of specific German and British banks.¹ Most existing case studies concentrate either on a time-span that is too short to identify certain strategic patterns or focus too exclusively on specific business strategies (e.g. "retail banking strategy"). This research therefore concentrates on the principal players within a macrostructure and looks at the changing positions of British and German banks within the financial system, from the beginning of the Single European Market in 1993 until the end of 2003.

For three reasons it appears pertinent to analyse the period between 1993 and 2003. First, in 1993 the Single Market Programme (SMP) was completed, bringing about wide-ranging changes for the financial services industry in the following years. Second, it takes several years for strategic adjustments to be implemented at large financial institutions and to show results. Third, the time between 1993 and 2003 spans one full business cycle in Britain and Germany. The business cycle, measured as real GDP growth (year-on-year), is an important indicator of the macroeconomic conditions in which banks operate.

¹ Case studies produced by investment banks, consultants, academics and well-informed financial journalists. For case studies produced by academics, see e.g. Channon (1986), Rogers (1999), Beckmann et al. (2002).

The title of this thesis, "A comparison of British and German banking strategies in the context of European financial integration between 1993 and 2003" indicates that it is concerned with the analysis of realised strategies in a changing macroeconomic and political environment. This analysis does not focus on the question of whether a realised strategy differs from the strategy initially intended, i.e. how strategies emerge. Rather, it aims to increase understanding of European financial integration by enhancing knowledge of "realised" corporate strategies (Mintzberg & Waters, 1985).²

The largest British and German banks are major pillars of the European financial system. It is widely argued that the British and German financial systems demonstrate fundamental differences (Butt Philip, 1978; Davis, 1998; Schmidt, 1999; ECB, 1999; Howells & Bain, 2002). While the British financial system is more capital-market oriented and far more concentrated, a highly fragmented banking market dominates the German system. These structural differences and subsequently the different approaches of British and German banks render a comparative investigation of the varying banking strategies in these two countries worthwhile, especially if the aim is to comprehend how these differences could possibly lead to the emergence of one coherent European financial system (Schmidt, 1999).

The rapid liberalisation of the European market and the rest of the world in the 1990s opened up unprecedented strategic opportunities for banks. New opportunities emerged from greater geographic reach, progress in information technologies, disintermediation and the development of new financial products. The broadening of choices required banks to prioritise and make decisions. Effectively, they needed a strategy, or had to review their existing strategies in the context of the changing macroeconomic environment. Although the emergence of new opportunities was managed differently by different institutions, market liberalisation basically seems to have prompted two fundamentally different strategic reactions among the banks analysed.

It is hypothesised that one reaction took the form of a defensive strategy, in other words, certain banks remained focused on their domestic market. For a strategy of this type to be successful, a bank needs assets and capabilities

² Mintzberg and Waters distinguish between "realised" and "intended" strategies – an approach which will be discussed in the third chapter of this thesis.

that are specific to the domestic market (Adamides, et al., 2003). The other strategic reaction fully embraced all new opportunities and led to an international multi-business strategy.

The different outcomes of these two strategic reactions appear to corroborate the theory that a financial system is a configuration of its subsystems with a coherent structure (Schmidt, 2001). It is argued that this coherence, which contributes to the stability of a financial system, also poses a challenge for the integration of national financial systems. Thus, the stability of such a coherent system also renders it relatively resistant to structural change (Hackethal & Tyrell, 1998; Hackethal & Schmidt, 2000; Schmidt, 2001).

This research investigates whether banks which pursued a defensive strategy and therefore stayed within a coherent financial system fared better than those which attempted to break out of a coherent financial system in order to embrace new, for example, international, opportunities which were not compatible with the prevailing system. More specifically, this thesis seeks to enhance understanding of

- A) how and why British and German banking strategies differed in an increasingly integrated European economic system and
- B) why market liberalisation seems to have provoked two fundamentally different strategic reactions among banks, neither of which appears to have significantly promoted European banking integration.

By answering these two questions this research should also offer an explanation of why European banking integration did not progress as far as had been envisioned by the European Commission and suggested by analyses such as the Cecchini Report at the outset of the Single European Market. Moreover, as an intertemporal two-country analysis, this research endeavours to identify whether there were national or periodic patterns in banking strategies. Besides theory building and offering an alternative explanation as to why banking integration remained slow during the first decade of the Common Market, this research also serves two additional purposes, which are of academic and practical importance.

First, at least to the knowledge of the author, no condensed and comparative analysis of the strategic positioning of major European banks (after 1993), has yet been undertaken. A comparison of past successes and failures may help senior management to better evaluate the opportunities and risks inherent in managing their institutions. This is even more important as there appears to be ample evidence that banks suffer from institutional memory loss, which makes them prone to repeat the same mistakes (Berger & Udell, 2003).

Second, only a few regulators, central bankers, politicians, and policymakers have the resources to study developments at individual banks, corporate strategies in general and banking strategies in particular. For them this research should also offer a valuable source of information about the interaction of the micro and macro structures of the financial system they are expected to manage.

This research applies a methodology that is unique in the study of European financial integration and the banking sector. The methodology, which is rooted in Giddens' ontological concept of structuration (Giddens, 1984, 1988), recognises the interdependence of the macro and micro levels of a financial system. The multiple longitudinal cross-country case study approach requires a thorough understanding of the macro themes that condition banking strategies, the microeconomics of banking and strategic management theories. In order to deal with the intrinsic complexity of this investigation and to narrow the research problem, bank-specific issues arising from European integration and strategic management concepts are reviewed and discussed ahead of the empirical research, i.e. the case studies.

Although this research assumes that the realised corporate strategies are a reality that can be observed, multiple perspectives are adopted (Easterby-Smith et al., 2002). In order to strengthen the validity of this research, different methods are used to study the realised strategies of banks. Triangulation is achieved through two qualitative methods with two different data sources and one quantitative method with a third set of data. Interviews fulfil only a supplementary function where the other sources do not show a clear picture.

The subordinated role of interviews results from the decision to analyse the realised corporate strategies of publicly listed banks as opposed to emerging business strategies at non-listed institutions. Corporate strategy involves the allocation of resources and capital in a manner that entails a structural shift for the organisation which cannot be easily reversed. Since corporate strategies can imply substantial structural, financial and legal consequences, the firm's owners have to be notified. Thus, management of publicly listed companies must inform the shareholders about the firm's corporate strategy. Consequently, all relevant strategic decisions are public knowledge and an interviewee can only provide limited additional information.

Chapter two reviews the changing playing field for banks and deals with the question of what is a financial system in general and what is the European financial system in particular. In **chapter three** corporate strategy analysis and its applicability to the banking sector is outlined. It is regarded as pivotal to discuss the understanding of the term strategy prior to discussing strategic management concepts. For this reason, and because of the politically sensitive nature of national banking systems, this starts from a review of the origins of the term strategy and then links its political/military roots to contemporary banking strategies. **Chapter four** elaborates the underlying ontological concept of structuration, the methodology and the different research methods used.

In **chapter five** the eight case studies are presented and discussed. The analysis of the individual banks is preceded by a concise introduction about the specific features of the British and German banking landscape. The banks researched are The Royal Bank of Scotland (RBS), HSBC, Barclays and Lloyds TSB in Britain and Deutsche Bank, Dresdner Bank, Commerzbank and HVB in Germany. In **chapter six** the microeconomic findings of the case studies are tied together and a cross-case pattern analysis puts them into the context of European financial integration. This chapter concludes by answering the research questions, recommends complementary research and ends with an epilogue and a tentative outlook.

2. The playing field for banking strategies – EU financial integration

2.1. Introduction

Banks constitute an integral part of a financial system. Financial systems are subject to political, economic, social and technological changes (White, 1998, pp. 4-9; Schmidt, 2001, pp. 7-15). "PEST analysis"¹ distinguishes between influences from the macro-environment and the micro-environment (Grant, 2002, pp. 66-67; Narayanan, & Fahey, 2001, pp. 189-214). The financial system provides the macro-environment for a bank, although the aggregated banking sector is itself a vital part of this macro-environment. In contrast, the influences that form the micro-environment originate from the other competing banks and customers who, as providers of deposits, are also the bank's "suppliers" (Grant, 2002, pp. 66-67).

Political changes in Europe, in particular the project to create a Single Market in Europe, impacted Europe's financial systems.² The Single European Market initiative and monetary union have significantly changed the macro-environment for European banks. Since the extent of integration is unique to European banks, this thesis concentrates on the environmental changes which come from the political sphere – banks in other parts of the world are equally exposed to technological changes, global economic issues and social factors.

Narayanan distinguishes between "scanning", "monitoring" and "forecasting" environmental changes which effectively lead on to an assessment of how they might affect an organisation. "In assessment, the frame of reference moves from understanding the environment - the focus of scanning, monitoring, and forecasting - to identifying what that understanding of the environment means for the organization" (Narayanan, undated, p. 14). Evaluating British and German bank strategies from 1993 to 2003 necessitates sketching out the most relevant macro-environmental change

¹ Analysis of Political, Economic, Social and Technological (PEST) factors affecting corporate strategies.

² It is arguable whether the singular or plural form of system(s) should be used. The more open and interconnected the coexisting systems are, the more they become one system.

affecting banks in Europe in that period, namely the integration of European financial systems.

Studying the integration of Europe's financial systems requires some clarity about what a "financial system" is and the meaning of "integration". Generally, financial integration is understood as the process that transforms formerly regionally separate financial systems so that they operate as a single integrated system (London Economics et al., 2002, pp. 12-13).³ The concept of integration entails the difficulty that there is no definition of when such a process is completed, unless the final state is assumed to be one of complete homogeneity in all areas, which would then raise questions about the stability of such a system.

In fact, this problem is encapsulated in the Preamble to the Treaty of Rome in which the founding members of what is now the European Union declared their determination to create an "ever closer union among the peoples of Europe" (Treaty of Rome, Preamble, 1957), suggesting an ongoing integration process. Nevertheless, on a more pragmatic level there are some indicators which can be used to measure the progress of financial integration. Foremost among them are the existence of a monetary union and complete freedom of capital, representing a high degree of financial integration. Other indicators⁴ of the degree of financial integration could be a lack of barriers to trading financial products across borders, few price discrepancies for the same financial product (Cecchini, 1988, pp. 37-42) and EU-wide diversification of financial intermediaries' assets and liabilities (Buch & Heinrich, 2002, p. 6).⁵

This chapter discusses the changing "playing field" for banking strategies and deals with the question of what is a financial system in general and the European financial system in particular. Building on a review of the considerations about disintermediation within a financial system, section three, "European financial markets – pooling liquidity" elaborates the relative importance of capital markets and financial institutions within the European

³ In this report prepared by London Economics, PWC and Oxford Economic Forecasting for the European Commission, the term financial markets also comprises the banking sector, therefore "financial market" is actually understood to refer to "financial system".

⁴ This list is far from being exhaustive and serves only to illustrate what different aspects might be considered for measuring financial integration. Part five of chapter one deals with the concept of integration at greater length.

⁵ Although Buch and Lapp (Buch & Lapp, 2000) suggest that diversification within Europe is not necessarily an optimal strategy.

financial system(s). Subsequently this chapter addresses the strategically relevant question of what a bank is, thereby sketching the main legal, regulatory and policy measures which provide the background for this analysis. Section five concludes by documenting the debate about the benefits of European financial integration and the expectations at the outset of the European Common Market.

2.2. European financial system(s): between markets and institutions

The purpose of a financial system is to channel funds from those who have a pecuniary surplus to their current spending plans to those who have a deficit. The facilities offered by a financial system can be distinguished between the matching of surplus and deficit units, financial services (e.g. insurance and pensions), payment mechanisms and portfolio adjustments (Henderson, 1993, p. 169; Howells & Bain, 2002). According to Howells and Bain, a financial system is “a set of markets for financial instruments, and the individuals and institutions who trade in those markets” (Howells & Bain, 2002, p. 3).

As financial markets essentially imply the trading of claims and rights, these markets are particularly dependent on a sound legal system, which provides a basis for contractual law. Consequently, financial markets are highly regulated markets. In particular, banking is one of the most regulated sectors in the European Union (Henderson, 1993, p. 23; Hartmann-Wendels et al., 2000, pp. 22-26). The judiciary of a sovereign nation state provides the legal framework for the financial market. Thus, it may be assumed that a financial system is also a national system (Henderson, 1993, p. 22). Financial integration therefore comprises integrating national financial systems. Subsequently, it may be postulated that the standardisation of legal parameters for financial markets is a necessary precondition for the integration of financial systems.

La Porta et al. (La Porta et al., 1997, 1998) and Cecchetti (Cecchetti, 1999) argue that the structure of a financial system is contingent upon the rights of shareholders and creditors and how these rights are enforced. Evidence presented by La Porta et al. suggests that countries with a common law system, for example, the United Kingdom, provide better investor protection than the civil law system prevalent in Germany and Scandinavia. Therefore, countries with a common law system foster the development of capital markets. This reasoning appears consistent with the argument that a financial system is a configuration of its subsystems, which complement each other, and that the coherence of such a system renders it resistant to structural change (Hackethal & Schmidt, 2000; Schmidt, 2001).

For the purpose of this thesis, a broad definition of a financial system, as put forward by Schmidt, (Schmidt, 1999) appears pertinent. He suggests that a “financial system includes the financial sector as the provider of financial services as well as the real sectors of the economy insofar as they demand or, as the case maybe, fail to demand, these services, and the complex relationships between the financial and the non-financial sectors” (Schmidt, 1999, p. 9). According to Schmidt, such a financial system is composed of four interrelated subsystems. The four subsystems he identifies are the “financial sector system”, the “financial patterns system” (the surplus and the deficit units), the “corporate governance system” and the “business system” (strategy regarding corporate finance), whereby in a stable system all four subsystems coherently coexist and complement each other (Schmidt, 1999, pp. 9-13).

2.2.1. Disintermediation within a financial system from a market perspective

A company can obtain capital through equity, bonds and loans. Bond and equity finance rely on the existence of liquid capital markets, i.e. markets with sufficient demand and supply, whereas the provision of loans requires a banking sector. Within the European Union, financial systems vary depending on the degree of credit finance, i.e. the relative significance of the banking sector. The importance of financial intermediaries relative to the financial markets determines the structure of a financial system. According to the European Central Bank, disintermediation, i.e. the "movement of services or functions (notably borrowing and saving) away from the banking business towards other financial or non-financial intermediaries, economic agents or markets" (European Central Bank, 1999, pp. 16-18) is a development across the EU financial systems, which should receive additional impetus from the European Monetary Union (European Central Bank, 1999, pp. 16-18).

It is widely argued that disintermediation is a general trend, which changes banks' balance sheet structures and furthers the liquidity of capital markets (McCauley & White, 1997; Davis, 1997; ECB, 1999; Eijffinger & Haan, 2000; Buch, 2001a; European Commission, 2002b; Walter, 2002). As markets can trade large volumes of savings while offering a diverse range of assets with varying risk-reward profiles, the transition from a bank-dominated to a market-oriented system seems to raise the risk-carrying capacity of a financial system (Henderson, 1993, p.169). Rybcynski suggests that the structural evolution of a financial system is dependent upon its ability to absorb risk, which is essential for innovation, capital formation, savings and growth (Rybcynski, 1984). He holds that a financial system develops in a three-phase process where the first phase is dominated by intermediation, the second is more market-orientated, leading to a third phase comprising a strong market orientation with extensive securitisation (Rybcynski, 1984).

In contrast, Schmidt et al. suggest that there is no general tendency towards disintermediation and securitisation in Europe, at least not in the UK and in Germany. Moreover, they dismiss the idea of an ongoing transformation from bank-based to capital market-based financial systems, which would imply a reduction in the relative importance of banks (Schmidt et al., 1998; Schmidt,

1999). Different definitions of “disintermediation” and different methodologies to measure the degree of disintermediation lead to such diverging arguments, which will not be discussed at great length as part of this research. In fact, in a later paper Schmidt concedes, “the importance of banks relative to capital markets will decline in the future” (Schmidt, 2001, p. 21). Yet he maintains, “this does not imply that the financial systems in continental European countries will soon change their general character and become capital market-dominated” (Schmidt, 2001, p. 21).

Different degrees of disintermediation matter particularly for the transmission mechanisms of monetary policies in a financially integrated Europe. For this reason, monetary economists show concern about possible spill-over effects from the international activities of banks which could contribute to contagious cross-border bank runs (Allen & Gale, 2000; Buch, 2001b). A review of the literature about monetary transmission mechanisms in Europe is provided by Dornbusch et al. (Dornbusch et al., 1998), Eijffinger and Haan (2000, pp. 146-155) and can also be found in Buch’s “Financial Market Integration in a Monetary Union” (Buch, 2001a).

For the context of this doctoral research, it is worth pointing out that Buch presents “some evidence for the hypothesis that German shocks are transmitted through the international lending activities of commercial banks, and that these transmission effects affect credit conditions in the host economies to some extent.”⁶ (Buch, 2001b, p. 5) However, the overall conclusion by Buch is that at an advanced stage of financial integration bilateral linkages are less important. Consequently, financial shocks are likely to spread more evenly across regions, thus the risk of contagion declines (Buch, 2001b, p. 41).

In his research into monetary transmission mechanisms and European financial systems, Schmidt emphasises that the greatest distortion for the transmission mechanisms of a monetary union emerges when a consistent financial system partially loses its consistency and its intrinsic balance (Schmidt, 1999). It is during the phase when there is growing pressure to restore consistency, which leads to an instable transmission mechanism, that monetary policymakers find it difficult to determine the impact of their

decisions. He concludes that the risk of systemic instability and the disorientation of monetary policymakers “constitutes a bigger problem for a common currency than the need to design and implement a common monetary policy for different, but essentially stable, financial systems [...]” (Schmidt, 1999, p. 27).

Consequences of disintermediation for monetary transmission mechanisms are one side of the coin and changing patterns of corporate finance are the other. While there is severe competitive pressure among banks within the fragmented European banking market, other industries benefit from more advanced consolidation of their sector by reaping synergies, which lead to greater efficiency. As noted by White (White, 1998, p. 13) lower information costs, greater transparency of accounting and the increased importance of rating agencies enable some companies to compete with financial intermediaries by raising funds on the capital markets. Therefore, disintermediation could also receive impetus from the growing competition between financial intermediaries and large corporates, which find it cheaper to raise finance via the capital market than via bank loans (White, 1998, p. 13).⁷

⁶ The countries most affected are: Austria, Denmark, Finland, and Ireland.

⁷ In this respect, the introduction of Basel II could increase the pressure on banks in their role as financial intermediaries. “In January 2001 the Basel Committee on Banking Supervision issued a proposal for a New Basel Capital Accord that, once finalised, will replace the 1988 Capital Accord. The proposal is based on three mutually reinforcing pillars that allow banks and supervisors to evaluate properly the various risks that banks face. The New Basel Capital Accord focuses on: (1) minimum capital requirements, which seek to refine the measurement framework set out in the 1988 Accord; (2) supervisory review of an institution's capital adequacy and internal assessment process; (3) market discipline through effective disclosure to encourage safe and sound banking practices” (Bank for International Settlement, 2003).

2.2.3. Pension reform and the implications for the financial system

Some commentators also argue that the need to reform unfunded state pension schemes in many European countries in the wake of dramatic demographic change is an additional underlying force that might enhance disintermediation (Butt Philip, 1978; Davis, 1997; Eijffinger & Haan, 2000). Unfunded old age pension systems, whereby a country's current working population finances the pensions of the present retired population, suffer from the longevity of citizens, along with shorter working lives. Consequently, this leads to an imbalance of the working force relative to the number of pensioners. Given that this development burdens government budgets, European states which retain generous unfunded social security systems are likely to weaken their position as international debtors and could thus face higher long-term interest rates. Therefore, many of these states are under great pressure to introduce pension reforms (De Ryck, 1997; Davis, 1997).

The overwhelming majority of literature on pension reform recommends greater reliance on funded pension schemes (for a detailed literature review see: Davis, 1997; Mantel, 1999; Holzmann, 1999). A funded scheme means that workers accumulate a stock of assets throughout their working life in order to finance their own pension. Further recommendations essentially comprise longer working periods (i.e. later retirement and less time spent in education), lower net pensions as a percentage of average net salary and higher pension contributions (Mantel, 1999).

Since funded pension schemes require suitable asset classes in which the accumulated capital can be invested, it is argued that the transition towards a more funded pension system would have repercussions for the financial market structure. Davis postulates that pension funds promote the supply of long-term funds to capital markets, financial innovation and modernisation of market structures which enhance the efficient allocation of funds (Davis, 1995, p. 178). However, he also concedes that the growing prominence of pension funds may also lead to higher market volatility, possibly raising the cost of capital for firms (Davis, 1995, p. 178).

On the significance of pension systems for European financial integration, Butt Philip remarks, "the way in which pension funds operate and are financed is

one of the most important factors in shaping the financial systems of different countries and in determining their functional efficiency” (Butt Philip, 1978, p. 322). Pension reform is arguably one of the prime strategic challenges financial services companies face at the beginning of the 21st century.

On the one hand, there are the implications for the capital markets, i.e. the impact of disintermediation and corporate finance. On the other hand, financial services companies need to answer the question of whether and how to position themselves in order to benefit from the “value chain” that provides private retirement-income solutions. These strategic considerations range from the practicability of online banking for elderly people to different approaches to institutional asset management.

Davis considers the forces unleashed by the introduction of a funded pension system sufficient to change a bank-dominated financial system, like the German one, into a capital market Anglo-Saxon-type financial system. He concludes: “on balance, the position of European banks would be weakened by pension-fund growth, but not wholly compromised” (Davis, 1995, p.178).

While pension funds play an important role as providers of corporate finance in Anglo-Saxon countries, the strong role of the state, along with a bank-dominated financial system, seems to have discouraged the development of financial markets in continental European countries (White, 1998, p. 6). White hypothesises that the well-developed state social security funds are an important reason for the rudimentary levels of private savings in states like Germany. He maintains that this resulted in a public policy which, until the mid 1990s, emphasised considerations relating to “stability” over those relating to “efficiency” (White, 1998, p. 6).

2.2.3. The role of the state in the financial system

In France, Italy, Germany and Spain a significant proportion of the market share has traditionally been controlled by the state, largely via the savings banks sector (White, 1998, p. 6). However, the EU's competition policy requires the state to gradually withdraw from the banking sector (Van Miert, 1998; Monti, 2002). Nevertheless, the influence and in particular the changing influence of the state on the continental European banking sector must not be underestimated in an analysis like this. In chapter five of this research the repercussions of the state's retreat from the banking sector for Germany's savings banks (Sparkassen), state-owned regional banks (Landesbanks) and cooperative banks (Volksbanks) and other private banks is considered.

The prominence of the state in the banking industry led to a constellation within some European financial systems that made it impossible for financial institutions to take decisions on the basis of free market principles. It is argued that the extent of intermediation within a financial system is derived from the risk-return optimisation of financial institutions, contingent upon the operating costs, regulation, and not least the prevailing market structure (Henderson, 1993, p. 169). However, this argument does not consider that state actors within the financial services industry might largely determine the "market organisation" because their risk-return requirements may differ from those of non-state market participants.

Moreover the interests pursued by the state through its financial institutions may focus on objectives other than profit maximisation, for example, the financing of infrastructure projects, which might be appropriate as part of the government's economic policy. However, in some cases these state institutions are so well-established that the economy has become structured accordingly. This is, for example, the situation in Germany where savings banks still enjoyed state credit guarantees some 45 years after the end of the European Recovery Program (1948-1957), which was aimed at rebuilding European infrastructure.

When evaluating the role of the state in Europe's financial systems, it has to be recognised that the ultimate decisions and the specific policies leading to, for example, a reform of the pension system remain in the hands of national

governments. By providing certain incentives (e.g. tax breaks) and modifying the legal framework, the conditions under which a bank would benefit from the introduction of a funded pension system are determined by the state. Effectively scaling back the state's role as a provider of social security is a sovereign decision which has to be taken by the state itself.

Not least because of the differing roles of the state, it is argued that the German and British financial systems are the most widely divergent in Europe (Schmidt, 1999, pp. 13-17). Within the European Union, Britain enjoys the most developed, open, diverse and strongly market-oriented financial system, characterised by low levels of gearing. Whether a financial system is considered more bank-based or more market-oriented is usually measured by indicators such as the total assets of banks and stock market capitalisation as a percentage of GDP (Schmidt, 1999, p. 13). Given the large and liquid capital markets in the UK, the British corporate sector depends on equity and bond finance rather than bank finance. Therefore, insurance companies and pension funds play a major role in channelling funds to British industry (Butt Philip, 1978; Henderson, 1993; Schmidt, 2001).

On the other hand, the continental European systems, foremost the German bank-based system, feature capital markets and capital market-oriented institutions such as pension funds which appear 'underdeveloped' relative to Britain (Schmidt, 1999, p. 13). Howells and Bain point out that the total value of equities in the financing of German non-financial firms in 1998 was about 0.5 percent of GDP, whereas the comparable figure in the UK was 2.3 percent (Howells & Bain, 2002, p. 117). One characteristic of the German financial system is that companies have a high proportion of bank loans on their balance sheets. This high gearing and the implicit low level of equity financing, along with the well-developed social security system have not helped the development of an "equity culture" among German retail investors. Consequently, capital markets are narrow and bank instruments dominate households' asset portfolios (Butt Philip, 1978, p. 302; Henderson, 1993, p. 185; Schmidt, 1999, pp. 13-14; Schmidt, 2001, pp. 5-7; Howells & Bain, 2002, p. 120).

Contrasting British and German bank systems at the beginning of chapter five reveals some of the country-specific conditions with which banks are

confronted. Of all the multifaceted developments in the European financial system, one of the most daunting strategic tasks for banks is how to optimise their function as intermediaries (Diamond, 1984, pp. 393-414). More specifically, banks face the question of whether and how they could benefit from a possible trend towards disintermediation. In order to successfully tackle these challenges, banks should correctly assess the dynamics and patterns of the European financial system. Whether banks deal with disintermediation by providing transaction services or attempt to manage information asymmetry more efficiently in order to maintain a competitive advantage, in either case, they will develop financial instruments and take advantage of liquid capital markets. Therefore, the multiple markets for financial products, which are addressed in the following section, will remain their playing field.

2.3. European financial markets – pooling liquidity

Deregulating the European banking market was one of the primary objectives of the Single European Act, which paved the way for the creation of the Single Market. Specific policy measures, especially the Second Banking Directive, facilitated the creation of a Single Market and in particular raised expectations that cross-border banking would be stimulated (Buch, 2000; Buch, 2001, p.6). Before documenting the debate about the integration of the European banking market, this section considers the degree of integration of the financial markets, where banks are clearly the principal actors, alongside insurance companies and various types of asset managers. According to the European Commission, “the primary function of any financial market is to allocate economic resources, both across borders and across time, in an uncertain world. Viable investment projects are selected and funded, thereby contributing to the development of the economy” (European Commission, 2002a, p. 11).

Bodie and Merton (Bodie & Merton, 1995) identify six core functions of the financial markets. First, financial markets provide ways of clearing and settling payments, thus enabling trade and the exchange of goods, services, and assets. Second, a mechanism is provided for the pooling of funds and for subdividing shares in enterprises to facilitate portfolio diversification. Third, financial markets facilitate the allocation of resources across time and space. Fourth, by using financial products that can be bought and sold on these markets financial risk can be better managed. Fifth, prices convey condensed information, thus a liquid financial market facilitates decentralised decision-making. Finally, financial markets provide an infrastructure to deal with “the incentive problems created when one party to a transaction has information that the other party does not or when one party acts as an agent for another,” i.e. they offer ways of dealing with information asymmetry (Bodie & Merton, 1995, p. 5).

Essentially, there are three distinct financial markets within a financial system: the equity market, the bond market and the money market - all of which can be further subdivided into segments. For example, the derivatives market may be regarded as a separate market in its own right (Howells & Bain, 2002, pp.

283-436). Financial markets that are part of different currency zones are linked with each other via foreign exchange markets.

Another classification of financial markets distinguishes between groups of market participants. As most actors on these three markets are financial institutions that carry out large transactions⁸ with each other, these markets are often described as wholesale markets (Cabral, et al., 2002, p. 11). In contrast, there are also retail markets for financial products, with households and small and medium-sized enterprises (SMEs) on one side and financial institutions on the other. Wholesale and retail markets and thus the financial institutions which operate in these markets constitute an important part of a financial system.

The introduction of the euro has provided remarkable impetus for the integration and growth of capital markets. Prior to European Monetary Union, foreign exchange risk, different risk-free yield curves and currency-matching rules impeded geographical diversification of investment by institutional investors (Cabral, et al., 2002, p. 20). Therefore, the size of capital markets was limited and thus fragmented. Following the launch of the euro, these constraints have essentially been eliminated (Cabral, et al., 2002, p. 20).

⁸ Often these transactions are carried out on behalf of two parties that bank with different institutions.

2.3.1. Money markets

Following the introduction of the euro, the wholesale markets have rapidly integrated, although the degree of integration varies across the different market segments (European Commission, 2002a). Most prominent has been the emergence of a single European money market (Cabral, et al., 2002, p. 11), in which funds are borrowed and lent for a maximum of one year (Howells & Bain, 2002, p. 284).⁹ The money market consists of various “submarkets” which are usually distinguished by instruments, e.g. commercial paper, treasury bills, repurchase agreements, etc.

The integration of money markets after European Monetary Union was greatly facilitated by EURO1¹⁰ and TARGET¹¹, the real-time gross settlement systems for euro-denominated payments throughout the EU. For example, around 60% of total interbank activity of the largest market participants is cross-border, illustrating that the market for interbank deposits has more or less completely converged (Solans, 2002; European Commission, 2002a).

Overall the money market is highly integrated. The “law of one price” took effect only a few days after the launch of the euro and seems to have hold up well since then (Solans, 2002; Cabral, et al., 2002). The only exception appears to be found in the repo market (repurchase market),¹² where research by Ciampolini and Rhode (Ciampolini & Rhode, 2000) identified price differentials, indicating that this segment was the least integrated of the money markets.

For banks, particularly commercial and retail banks, the money market is the key to liquidity management and therefore crucial for operational management. A large and well-integrated money market, without foreign exchange risk, should lead to cost benefits and efficiency gains. Liquidity, defined as “the ability to refinance maturing liabilities at or below market rates” (Golin, 2001, p. 300), is essential for a bank’s survival. Insufficient liquidity is one of the main reasons for bank failures (Golin, 2001, p. 299). Consequently,

⁹ In fact, many are just “overnight” transactions.

¹⁰ EURO1 is the Euro Banking Association’s net settlement system.

¹¹ TARGET = Trans-European Automated Real-Time Gross Settlement Express Transfer System.

¹² “Under a repo agreement, a bank agrees to sell fixed income securities, usually government treasury bills or bonds, with guarantee to repurchase them later at a predetermined rate and price” (Golin, 2001, p. 320).

a bank's liquidity management could pose a major threat to the realisation of its strategic objectives. That said, money markets, as any market, also open up trading opportunities, which may allow for trading gains.

2.3.2. Bond markets

Proprietary trading in bonds has also gained significance among European banks following the creation of EMU. More profoundly, the progress towards financial integration has had an even greater impact on the bond market structure in Europe. A fourfold distinction seems pertinent for the purpose of this research: First, it is worthwhile distinguishing between corporate and government bonds as corporate bonds are an important force behind disintermediation. Second, it is helpful to separate the analysis of the primary bond markets, i.e. bond issuance, from the analysis of secondary market, i.e. bond trading, as these two markets also differently affect distinct divisions of a bank.

Although the introduction of the euro has triggered strong growth in euro-denominated corporate bond issues by European non-financial corporations, this market appears to be still in its infancy compared to that of the United States.¹³ Research by the European Commission also suggests that the corporate, i.e. non-financial, bond market has not lived up to its potential (European Commission, 2002a, p. 15; 2002b, p. 160).

Direct market access to long-term capital at low cost enables companies to diversify their range of options to finance long-term investments. A large and liquid corporate bond market should reduce the cost of debt for companies outside the financial sector. This is supported by a noticeable decline of credit spreads as investors have become more familiar with European non-financial corporate debt (London Economics et al., 2002, p. 97). Given that corporate bonds are likely to be a substitute for bank lending and promote disintermediation, an economy's dependency on bank financing should diminish relative to bond financing. This wider risk-sharing basis enhances the stability of the financial system (European Commission, 2002b, p. 159).

Differences in bond yields result from expectations of exchange rate fluctuations, different tax regimes, credit risk and liquidity. The exchange rate uncertainty was eliminated when the euro was introduced in January 1999.

¹³ For example, in mid 2002 the total size of euro-denominated bond market stood at around USD 8,137 billion, whereas the dollar-denominated bond market was valued at USD 19,539 billion (London Economics, et al., 2002, p. 56).

Despite yield spreads of 10 to 50 basis points for government bonds, the European Commission describes the government bond market within the euro area as highly integrated (European Commission, 2002b, p. 11).

Although it is argued that the persisting yield spreads, which largely exist relative to German government bonds, due to varying liquidity and are thus not a reflection of credit quality, it appears plausible that follow the end of national interest rate policies the market for European government debt securities mirrors the national budgetary situation (European Commission, 2002b, p. 158). As the budgetary situation could deteriorate more in some euro zone member states than in others, a widening of yield spreads might result.¹⁴ In that respect the European Monetary Union has enhanced the competition between national governments, with each nation struggling for better refinancing conditions on the capital markets.

From a European investor's perspective one positive consequence of differing yield spreads is the greater opportunity to diversify government bond portfolios, of which they have largely been deprived since EMU (Brookes, 1999, p. 22). As many European investors are inclined to hold bonds to maturity, (London Economics et al., 2002, p. 97) it is foremost the primary bond market, i.e. the market for issuing debt, which has received impetus from the existence of a single currency in Europe.

Euro-denominated corporate bond issuance has risen markedly since the introduction of the euro. The European Commission notes, "[...] the market share of private issuance is now about half of total issuance (more than quadrupling since 1998), average maturities have lengthened, and issue sizes have increased with tranches above EUR 1 billion now commonplace" (European Commission, 2002a, p. 15). Cabral, et al. remark that the corporate issue volumes in 2001 are sixteen times higher than in 1995 and conclude that "this reflects the increased trust in stable borrowing costs and the ability of firms to go beyond their domestic markets under the single currency conditions" (Cabral, et al., 2002, p. 11).

However, the secondary corporate bond market, i.e. the market where corporate bonds are actually traded, is still not very liquid. Most non-

government bonds are still traded over-the-counter (OTC), which impedes transparency and liquidity. Yet it seems inevitable that the increasing activity of the primary corporate bond market will lead to the emergence of a liquid and transparent secondary bond market.

By assuming that the European financial market could increasingly resemble the US financial market, London Economics concludes that “[...] the share of bond financing will increase while the share of bank financing will fall so that the current gap between the share of bond financing in total debt financing between the U.S. and the European Union is reduced by a quarter” (London Economics et al., 2002, p. iv).

The changing landscape of Europe's bond markets requires banks to actively address the ongoing process of disintermediation by strategically refocusing on bond underwriting services in order to benefit from this trend. Developing a core competency as a bond underwriter could also help institutions generate profits from bond trading, which might even out the more volatile equity business. Moreover, the advance of corporate bonds results in a convergence of equity and bond products, giving rise to hybrid products, such as subordinated loans and convertible bonds.

The European Commission argues that the wholesale market for financial products has integrated relatively well, with the exception of the equity markets. This has been especially the case since the launch of the euro. One elemental reason being the ability of players on the wholesale market to access and assess information in order to overcome obstacles to integration, e.g. by buying legal expertise (European Commission, 2002a, p. 14). However, the European Commission concedes that overcoming these obstacles ties resources and thus bears certain costs, which are ultimately passed on to consumers and enterprises (European Commission, 2002a, p. 14).

¹⁴ Not all member states of the euro zone have the same credit ratings.

2.3.3. Equity markets

Bringing down the costs for cross-border trading is a prime concern of the European Commission and is at the core of the Financial Services Action Plan (FSAP). The 43-point Financial Services Action Plan, launched in 1999, aimed to remove the remaining barriers to integration in the European financial services industry by 2005 (Deutsche Bank Research, 2002). The FSAP agenda which, among other things, aimed to harmonise the EU wholesale market, also addressed the continued high cost of cross-border equity trading. Due to the high cross-border clearing and settlement fees, which are a multiple of the lowest fees charged for national trades, buying and selling of equities across different countries within the EU is more expensive than within national borders. This illustrates that further integrating the equity markets and the eventual emergence of a pan-European stock exchange, needs to be preceded by the creation of a single European clearing house (Cabral, et al., 2002; Janssen, 2003b).

So far, three stock exchange operators have emerged as Europe's dominant players: the London Stock Exchange, Deutsche Börse and NYSE Euronext¹⁵ challenge the other European stock exchanges by attracting liquidity to their trading platforms. Europe's biggest cash equity market remains in the hands of the London Stock Exchange. However, the only pan-European stock exchange is NYSE Euronext, which comprises the European cash equity markets of the Amsterdam, Brussels, Paris and Lisbon bourses as well as the London-based derivatives market Liffe. Deutsche Börse is the majority shareholder of the world's second largest derivatives market, Eurex, and operates Xetra.

The fragmented stock market landscape is also mirrored in the national structures of the issuing services for equity (initial public offerings, i.e. IPOs). Cabras et al. contrast the more integrated bond markets with the equity markets where local banks maintain a prominent position, not least by highlighting the importance of local knowledge for adequately assessing risk (Cabral, et al., 2002, p. 5). Despite the continued national bias in the equity underwriting business, research by Chelley-Steeley and Steeley (1999)

¹⁵ In April 2007, New York Stock Exchange (NYSE Group) merged with Euronext to form the first transatlantic stock exchange group.

indicates that, overall, European equity markets have become more integrated following the removal of exchange controls. In fact, they demonstrate that the abolition of exchange controls has noticeably promoted equity market integration within Europe (Chelley-Steeley & Steeley, 1999).

Ahead of EMU, institutional equity investors gradually abandoned national approaches to managing investments and chose pan-European indices like Euro-Stoxx, as their benchmark. Consequently, fund managers restructured their European portfolios along to sector lines. This shift towards sector investment has been corroborated by empirical evidence on equity price movements (European Commission, 2002a, p. 15). Furthermore, a survey carried out by Goldman Sachs, a US investment bank, (Goldman Sachs, 1998a; 1998b; Brookes, 1999) illustrates that a majority of fund managers organised their equity portfolios on a sector basis in the run-up to European Monetary Union.

Empirical research undertaken by London Economics (in association with PricewaterhouseCoopers and Oxford Economic Forecasting) for the European Commission (London Economics et al., 2002, pp. 16-53) suggested that equity trading costs could fall sharply as financial integration progressed. Moreover, their research reveals a positive correlation between the cost of trading and the cost of equity, whereby “the cost of equity is the rate of return investors require on an equity investment in a firm” (Damodaran, p. 182, 2002). This “required” rate of return is often derived with the help of the capital asset pricing model¹⁶ (CAPM), which is the most common risk and return model, despite some well-known pitfalls (for a review see: Damodaran, 2002).

London Economics maintains, “the broadening of the investor base for a given stock leads to a lower cost of equity, through greater risk pooling. The required rate of return on a given risky asset depends crucially on the covariance between the payoff to that asset and the payoff to the “market portfolio”, i.e. its systematic risk. As a given market becomes more open, the degree of foreign ownership rises. The required rates of return fall in the local market, because external investors require a lower rate of return to compensate for bearing risk that is at least partially diversifiable” (London Economics et al., 2002, p. 3).

Consequently fully integrated European equity markets could reduce the average cost of equity by more than 0.40%. The data used in the research by London Economics also reveals that the cost of equity in Germany would decline by 0.20 percentage points more than in the UK (London Economics et al., 2002, pp. 16-53).

Evening out the volatile equity business poses a major strategic challenge for banks. The repercussions of business volatility are aggravated by the serious strategic implications of increasingly integrated equity markets. As indicated, the consequences range from organisational structure and with it the product range offered for asset management clients to advice on equity underwriting for the corporate sector. Comparing US and European equity market capitalisations suggests that disintermediation in Europe could also be expedited by further equity issuance. Banks, which fail to provide underwriting services on a pan-European level are likely to find it difficult to place the issued equity with institutional investors across Europe.

Moreover, the trading of shares across national borders is effectively impeded by 15 barriers to efficient cross-border clearing and settlement within Europe (Giovannini Group, 2001). According to the findings of the first Giovannini Report (Giovannini Group, 2001) the settlement of cross-border transactions within the EU is substantially less efficient than the settlement of domestic transactions.¹⁷ Clearing and settlement are essential features of a smoothly functioning securities market, providing for the efficient and safe transfer of ownership from the seller to the buyer (Giovannini Group, 2001, p. i). The evidence presented in the Giovannini Report “points to a stark contrast in the cost of domestic and cross border settlement in the EU, suggesting a need to address sources of fragmentation in the infrastructure” (Giovannini Group, p. 43, 2001). Resolving the cross-border clearing and settlement issue is likely to be accompanied by the aforementioned consolidation of Europe’s stock exchange operators.

However, important as these infrastructural matters are for the emergence of a truly pan-European equity culture, soft factors, like a better understanding of

¹⁶ CAPM: $\text{expected return} = \text{risk-free rate} + \text{beta} \times (\text{risk premium})$; whereby beta is defined as the covariance of the asset divided by the market portfolio and thus expresses the risk added by an investment to the market portfolio (Damodaran, 2002, p. 71).

foreign stocks are equally important in order to overcome national barriers. Cultural differences are another obstacle to integration of Europe's retail markets for financial services. They are addressed in the following section.

¹⁷ The Giovannini Report suggests that the costs per cross-border trade are about 11 times higher than for domestic transactions.

2.3.4. Retail markets

“[Financial] retail markets are the part of the financial system where consumers and many enterprises [...] purchase financial services” (European Commission, 2002a, p. 17). According to the European Commission, the financial services retail markets are far less integrated than the wholesale markets and the difficulty of overcoming these obstacles appears greater (European Commission, 2002a, p. 19). The lack of integration is, for instance, reflected in the limited convergence of consumer lending rates (Kleimeier & Sander, 2002). An additional example is the absence of a fully automated processing of payments within the euro zone, what is known as straight-through processing (STP), which keeps the charges for cross-border retail payments unnecessarily high (Deutsche Bank Research, 2003). Furthermore, the Gyllenhammar Report notes “direct cross-border business between financial service suppliers and end consumers is still the exception” (Heinemann & Jopp, 2002, p. 11).

As consumer households are likely to be less well informed than enterprises and cannot rely to the same extent on extensive legal advice, the retail market for financial products is subject to stringent consumer protection regulation. In 1989, the Second Banking Coordination Directive granted Europe’s banks the right to set up branches in other EU member states and to trade in financial services across the EU once they had been approved by their home-country authorities¹⁸ (Deutsche Bank Research, 2002; Howells & Bain, 2002). However, this freedom was infringed by applying the “host-country control” rule for many aspects of retail banking. Overriding home-country control guarantees that the host country’s consumer protection laws remain under national control, implying that there is only minimal harmonisation of consumer protection rules.

Consequently, foreign banks that sell, for example, consumer credit or saving products to retail clients have to comply with the regulatory framework for local consumer protection and with laws which serve national public interest (Henderson, 1993, pp. 23-25). Given such a policy, economies of scale are difficult to realise. This is illustrated by the 15 different regulatory approvals a

¹⁸ This established the so-called Single European Passport.

financial institution requires in order to market one financial product EU-wide.¹⁹ One aim of the Financial Services Action Plan (FSAP, 1999-2005) was to resolve this matter by combining mutual recognition in legal matters, based on the country-of-origin principle, with harmonisation of the rules of conduct essential for investor protection (European Council, 2002, p. 40). Nine measures were forward by the FSAP to promote “open and secure retail markets”. These included policies on the distance selling of financial services, financial service providers’ duty of information towards purchasers, and cross-border payments (Deutsche Bank Research, 2002).

Due partly to national consumer protection laws, and partly to “natural barriers” to integration such as language, mentality and cultural issues, the retail markets for financial products are much more cumbersome to integration than the wholesale markets (Heinemann, & Jopp, 2002, p. 46). Moreover, differences in legal and tax regimes prevail and proximity to customers appears to be important for the retail business (European Commission 2002a, p. 19).

The Gyllenhammar Report²⁰ comments on the market for online brokerage/banking that “the impact of the internet on the integration of retail markets for financial services does not meet optimistic expectations [...]” and that it does not overcome market fragmentation (Heinemann & Jopp, 2002, p. 11). Heinemann and Jopp, the authors of the Gyllenhammar Report, also show that until 2002 most entries into national banking markets occurred through mergers and acquisitions and not via “greenfield” investments (Heinemann, & Jopp, 2002, p. 22).

In retail banking, more than in wholesale banking, it is increasingly common to draw a distinction between the production and distribution of financial products. This development raises questions about where a financial services firm should be positioned within the value chain, a strategic matter that can be found at the core of the debates about bancassurance concepts and online banking.

¹⁹ For example, there are 39 supervisory authorities responsible for prudential supervision in the EU and on average a financial institution has to report to 20 supervisors in the EU (Pearson P.J. (2002) in Kremers, J. ed. et al. (2003)).

²⁰ A study commissioned by the European Financial Services Round Table (Gyllenhammar Report – prepared by Heinemann, F. and Jopp, M., 2002) suggests that the potential for higher growth through

Disintermediation seems to be less of a strategic problem in retail banking than in wholesale banking, mainly because the size of households means that the cost of individually accessing the capital markets for borrowing would be too high relative to the benefits. However, since the early 1990s retail clients across Europe have increasingly turned to capital market investments, via mutual funds (retail funds), unit-linked insurance or direct equity and bond investments. This changed savings behaviour has led to a relative decline in retail deposits, depriving banks of this source of funding. Although more retail clients interact directly with the capital market, thus contributing to disintermediation, it seems that a shift in European financial systems towards a market-oriented structure is more likely to originate from the wholesale market and corporate finance than from the retail sector (European Commission, 2002b, p. 159).

Given the pressure resulting from disintermediation in wholesale banking and the volatility of the equity business, banks might increasingly favour a strong footing in retail banking in order to stabilise their overall revenues. Yet, unfair competition in retail banking in some European states renders this a difficult undertaking. In Germany, unlike in Britain, low margins in retail banking may have conditioned many business decisions by banks. However, once the role of the state in banking has been scaled back across the EU, banks are likely to gradually focus on pan-European retail banking strategies, so opportunities within the most densely populated European countries should be at the forefront.

A key strategic problem for European retail banks lies in the question of how to benefit from demographic change, which is likely to increase the use of funded pension systems throughout Europe.²¹ Certainly, the incessant debate about pension reforms contributed to the prominence of bancassurance concepts among strategic considerations of decision-makers in the financial services industry. Next to cross-selling considerations, combining savings and insurance products is at the heart of the bancassurance debate.

financial integration could be 0.5% of GDP per year, or EUR 43 billion added annually to EU GDP (in 2000 prices).

²¹ Interestingly the Gyllenhammar Report warns that “there is the danger that new obstacles are created as a consequence of national pension reforms. The German example shows that very specific national requirements on new pension products can constitute additional barriers to entry for foreign suppliers” (Heinemann, & Jopp, 2002, p. 13).

While the bancassurance approach implies the convergence of savings and insurance products on the one hand, there also seems to be further specialisation on either production or distribution of financial services products on the other. In chapter three of this research, the strategic repercussions of embarking on a bancassurance and/or a specialisation course are investigated. Regardless of the course taken, these aforementioned developments inevitably provoke a controversy about the legal and economic definitions of a bank. Therefore, the following section deals with the central question of what a bank is.

2.4. What is a bank?

While the preceding sections outlined the discussion about disintermediation within a financial system from a market perspective, this section looks at the institutional pillars, namely the financial intermediaries. The argument that the European financial system might transform itself from a bank-based system to a capital market-oriented system calls for clarification of the concept of a “financial intermediary”.

Without discussing the theoretical question of what constitutes a financial intermediary at great length, this research accepts that there are financial intermediaries, such as banks, insurance companies and investment companies which are instrumental to the functioning of the financial markets as their activities provide the institutional framework. Clearly, there would not be any significant financial market without these financial institutions, neither would there be any financial institution without the existence of such markets.

The structure of a financial system is to a great extent contingent upon the institutions that make up the system. Unlike insurance and investment companies, banks play the most important role in maintaining the stability of a financial system. Therefore, this research focuses on banks, which makes it necessary to consider the definition of a “bank”. This can be approached in a threefold manner (Büschgen, 1993, pp. 9-26). Büschgen differentiates between a legal, a microeconomic and a macroeconomic definition of a bank - an approach that also appears functional for this research.

Consequently, this section first provides an overview of the bank-specific directives adopted at EU level, and then outlines the legal definitions of a bank in the United Kingdom and Germany. The second half of this section considers the microeconomic definition of a bank, which is inextricably linked to the macroeconomic concept of bank. The macroeconomic considerations lead to some concluding remarks about mergers and acquisitions within the European banking market.

2.4.1. The rationale for banking regulation

Prior to the discussion of a bank's legal status in the EU, Britain and Germany, it is necessary to explain why the banking sector is so heavily regulated. The banks' pivotal role within the financial system essentially stems from their transformation function, which implies the matching of monetary surplus and deficit units (Howells & Bain, 2002; Mishkin, 1986). It follows that the banks' significance for the supply of money to the economy and their function as deposit-taking institutions provide the rationale for banking regulation.

The liability side of a bank's balance sheet comprises many small, short-term deposits, while the asset side comprises a smaller number of long-term loans. This enables banks to carry out certain transformation functions: maturity, size, risk and spatial transformation (Büschgen, 1993, p. 19). It is important to recall that this is a demand-driven process, (Howells, & Bain, 2002, p 33), i.e. banks do not "generate" loans from deposits, on the contrary, the demand for loans is financed through deposits. Alternatively, banks can refinance their activities by issuing bonds.

Howells and Bain note that "cash comes into the hands of the public by being obtained from a bank [...and not because] there is a vast pool of unwanted cash outside banks as a whole waiting to be paid in, in order to increase deposits" (Howells, & Bain, 2002, p 33). This illustrates how banks as deposit-taking institutions²² take an active role in the supply of money to the economy (Mishkin, 1986, p. 9). The liabilities of banks are the money supply of a country, so increased financial intermediation by banks leads to greater liquidity, i.e. more money in the economy. Resulting from this role as a money supplier to the economy, banks' lending and deposit policies are essential to the monetary workings of an economy.

In the event of insolvency of a bank, especially a deposit-taking institution, this could lead to a panic among depositors, wanting, or simply having to withdraw money from other banks, eventually leading to a bank run. Furthermore, a high degree of interbank lending, which is aimed at serving liquidity management and to facilitate interbank payment transactions, could

²² A deposit-taking institution is the legal definition for a bank in the UK, according to the Banking Acts 1979 and 1987 (Oxford Dictionary of Finance and Banking, 1997).

accelerate a risk of interbank contagion.²³ The consequence could be significantly reduced liquidity, thus the whole financial system might be destabilised with detrimental repercussions for the economy (Howells & Bain, 2000, 2002; Diamond & Dybvig, 1983; Hartmann-Wendels et al., 2000, pp. 325-329).

Consumer protection is the other important reason for bank regulation. It is argued that retail clients have to be protected because of their relative ignorance of the workings of the financial system in general and about the specific practices of their bank (Hartmann-Wendels et al., 2000, p. 327). Virtuous as this line of reasoning appears, the protection of depositors is a necessary condition for sufficient confidence in the banking system. Therefore, the argument for consumer protection effectively supports the stability of the financial system.

For a regulatory, i.e. legal, definition of a bank the varying historical banking backgrounds rooted in different cultures and legal systems need to be taken into account. In the Anglo-American literature, a distinction is made between deposit-taking institutions (DTIs, e.g. banks and building societies) and non-deposit-taking institutions (NDTIs, e.g. insurance companies and investment houses) (Howells & Bain, 2002, pp. 32-67). These terms originate from the US banking system, which legally required a clear separation of commercial (deposit-taking) and investment (non-deposit-taking) banking between 1933 (Glass-Steagall Act) and 1999 (Gramm-Leach-Bliley Financial Services Modernization Act) (Walter, 2002, p. 24).

²³ An additional form of systemic risk can emerge if jointly financed projects are no longer viable and could not be completed as a result of one troubled bank, possibly leading to losses at the other banks involved (Carletti & Hartmann, 2002, p. 8).

2.4.2. Legal definition of a bank in the European Union

The distinction between DTIs and NDTIs initially prevailed in the British banking landscape with clearinghouses as DTIs and merchant banks as NDTIs. This separation served as the basis for the EU's First Banking Directive on Coordination of Regulations Governing Credit Institutions of 1977²⁴ (Büschgen, 1993, p. 13).

This bipolar definition is, however, difficult to reconcile with the German concept of a universal bank, which has traditionally offered both retail and investment (wholesale) banking services (Walter, 2002, p. 24). Differing definitions of banks and other financial services providers can imply competitive disadvantages at EU level as was claimed, for example, by some German banks in reaction to the First Banking Directive (Büschgen, 1993, p. 13).

The Treaty of Rome in 1957 paved the way for a common European market in financial services. Article 52 of The Treaty of Rome, the right of establishment; Article 59, the freedom to supply services across borders, and Article 67, the free movement of capital, provide the legal foundation for a common market for financial services (Llewellyn, 1992, p. 106).²⁵

²⁴ First Council Directive of 12 December 1977 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (77/780/EEC).

²⁵ The freedom of establishment for financial services companies was not translated into an EC Directive before the 1973 Directive on the Freedom of Establishment (73/183/EEC), which abolished all restrictions on freedom of establishment and guaranteed the freedom to provide services in respect of self-employed activities of banks and other financial institutions.

2.4.2.1. Treaty of Rome

According to Article 67 of the Treaty of Rome, the free movement of capital was only a means to ensure integration of the common market in goods and services. Therefore, it merely fulfilled a certain function and was not being an objective in itself (Treaty of Rome, Article 67; Howells & Bain, 2002, pp. 445). Article 67 suggests that governments considered monetary and capital issues essentially as matters of national sovereignty at the outset of the “European project” (Henderson, 1993, pp. 20-22). Europe-wide free movement of capital was in fact of secondary interest to the governments at the time. As Butt Philip remarks the Commission’s priorities did not change until the 1960s, when EC officials recognised that more harmonised European banking laws would be necessary for a Common Market to emerge (Butt Philip, 1982, p. 462).

Moreover, Article 73 allowed governments to restrict the freedom of capital movement “if movements of capital lead to disturbances in the functioning of the capital market in any Member State [...]” (Treaty of Rome, Article 73). Existing exchange controls, limitations on cross-border trade in financial services and barriers to the free location of financial institutions were additional barriers to integration which impeded the emergence of a common financial services market following the Treaty of Rome (Llewellyn, 1992, p. 106).

Paolo Clarotti of the European Commission also notes that Article 57 (2) of the original Treaty of Rome required the coordination of legislation relating to the banking profession. The implications of this need for “coordination” were reflected in the negotiations on directives to abolish restrictions on the freedom of establishment for banks and on banking supervision between 1965 and 1972. The cumbersome negotiating process already indicated that harmonisation would be difficult to achieve - even more so after the accession of the United Kingdom, Ireland and Denmark to the EC in 1973 (Clarotti, 1984, pp. 199-200; Reich, 1994, pp. 49-50).

2.4.2.2. First Banking Directive (77/780/EEC)

As a result of the growing awareness that harmonisation was too ambitious a policy approach to integrate the European banking market, the First Banking Directive on Coordination of Regulations Governing Credit Institutions of 1977 followed the principle of “host-country control”. According to the First Banking Directive, a credit institution had to be first licensed in its home country before it could enter the market in another EEC member state. On the basis of this licence from the country of origin the credit institution was then allowed to operate in other EEC member states, providing it was authorised to do so by the host country’s regulatory body and only if it complied with the same rules applied to local banks (“principle of host country control”) (Howells & Bain, 2002, p. 450; Büschgen, 1998, pp. 29-32).

For a credit institution to obtain authorisation it had to have adequate and separate capital from that of its owners. Moreover, the institution needed at least two directors (the so-called “four eyes principle”), plus a reputable and experienced management and it had to submit to the authorities a business plan (Clarotti, 1984, p. 213; Henderson, 1993, pp. 23-24; Howells & Bain, 2002, pp. 450). Effectively, the First Banking Directive meant that, for example, a UK bank in Germany could only do what German regulation allowed German banks to do in Germany (Llewellyn, 1992, p. 127).

Clarotti maintains that the First Banking Directive greatly improved the coordination of supervisory regulations within the European Community, which is a necessary condition for the creation of a common banking market. Following this directive, the supervisory authorities of the member states had to collaborate in monitoring the solvency and liquidity requirements of credit institutions, thereby “forcing” them to increase harmonisation (Clarotti, 1984, pp. 219-220).

Despite an integration policy which recognised the limitations of harmonisation in European banking regulation, the Banking Directive of 1977 provided a first common definition for a “credit institution”. The directive defined a credit institution as an “undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account” (European Commission, First Council Directive, 77/780/EEC).

It may be concluded that the EEC's First Banking Directive of 1977 established that all member states must have a formal licensing system for the operation of banks. Moreover, it was broadly agreed that all deposit-taking institutions should be subject to the same legal framework, with a few exceptions. Finally, following the First Banking Directive it became evident that the view that future legal harmonisation of the banking sector should remain primarily in the hands of the supervisory authorities and the bankers themselves (Butt Philip, 1982, p. 463).

In response to heavy lobbying from Britain, the European Commission applied a "narrow" definition of a bank in its First Banking Directive which excluded investment services (Butt Philip, 1982, pp. 462-463). However, according to German banking law (§1 KWG) such investment services are part of a bank's business and therefore have to be regulated by the German banking supervisory authority (BAKred, now part of BaFin). Due to different capital requirements for retail banks and banks which also offer investment services (universal banks), German banks argued that this divergent legal basis implied an economic disadvantage for them (Büschgen, 1998, pp. 29-32).

Prior to the Single European Act of 1986, the Directive on the Supervision of Credit Institutions on a Consolidated Basis of 1983 (Directive 83/350/EEC) also promoted the cause of a common European banking market. This directive took account of the increasing international activities of European banks and the numerous opportunities for offshore vehicles. In particular against the background of the international debt crisis at the beginning of the 1980s the European Commission recognised that it was necessary to monitor the banks' global reach. Therefore, this directive made it mandatory for a bank to be supervised on the basis of its consolidated accounts and for its capital requirements to be measured against its total business, irrespective of national boundaries (Clarotti, 1984, pp. 221-222; Llewellyn, 1992, p. 127).

2.4.2.3. Second Banking Directive (89/646/EEC)

In the 1985 Cockfield Report prepared for the European Commission, it was argued that a common market in financial services was essential for the completion of the internal market (Howells & Bain, 2002, pp. 446). Therefore, it recommended the removal of all restrictions on capital mobility and financial services. In order to create a mechanism which could remove these barriers the Cockfield Report proposed mutual recognition of each member state's regulatory and supervisory arrangements, thereby introducing the new "home country principle". Subsequently, the home country principle became the overriding principle for the Second Banking Coordination Directive (Llewellyn, 1992, pp. 123-124; Howells & Bain, 2002, pp. 446-447). According to the principle of "home country control", which has dominated European banking regulation since the Second Banking Coordination Directive of 1989 the legal definition of "a bank" is embedded within the national judicial system in which the bank operates.

In an article published in the *Journal of Common Market Studies* in 1984, Paolo Clarotti of the European Commission outlines the necessity of the principle of "home country control" for the emergence of a truly common banking market. He explains that "only by adopting, by means of coordination, the principle of "home country control"; that is to say, the supervision of the credit institution by its home country, with its corollary, the possibility of a credit institution, duly authorized by the competent authorities in its home country, able to have branches throughout the Community on the same conditions that it can open them within its home country, (conditions which moreover should be coordinated), can a truly common banking market come into existence, which would have the same characteristics as a present-day national market" (Clarotti, 1984, p. 200).

Following the Single European Act, the principles of minimum harmonisation, mutual recognition, and home country regulation were established. The Second Banking Coordination Directive of 1989 (89/646/EEC), which came into force in 1993, enabled banks to operate throughout the EU on the basis of a single licence (a "single passport") granted by the regulatory authorities in their home country (Howells & Bain, 2002, pp. 451-453). The directive also explicitly listed all banking activities which had to be mutually recognised, thus broadening the definition of a bank. These comprised:

(1) Acceptance of deposits and other repayable funds from the public; (2) Lending; (3) Financial leasing; (4) Money transmission services; (5) Issuing and administering means of payment (e.g. credit cards, travellers' cheques and bankers' drafts); (6) Guarantees and commitments; (7) Trading for own account or for account of customers in: (a) money market instruments (cheques, bills, CDs, etc.), (b) foreign exchange, (c) financial futures and options, (d) exchange and interest rate instruments, (e) transferable securities; (8) Participation in share issues and the provision of services related to such issues; (9) Advice to undertakings on capital structure, industrial strategy and related questions and advice and services relating to mergers and the purchase of undertakings; (10) Money broking; (11) Portfolio management and advice; (12) Safekeeping and administration of securities; (13) Credit reference services; (14) Safe custody services.²⁶

The Second Banking Coordination Directive was followed by further directives to harmonise details. These ancillary directives were the "Directive on the Annual and Consolidated Accounts of Banks and other Financial Institutions" (86/635/EEC) – harmonizing standards for annual and consolidated accounts of credit institutions; the "Own Funds Directive" (89/299/EEC) – defining minimum requirements of the bank's capital base, i.e. equity capital; the "Bank Solvency Ratio Directive" (89/647/EEC) – setting the standard for prudent solvency ratios in accordance with the Basel capital adequacy rules; the "Second Consolidated Supervision Directive" (92/30/EEC) – succeeding the "Directive on the Supervision of Credit Institutions on a Consolidated Basis" of 1983; the "Large Exposures Directive" (92/121/EEC) – standardising the requirements to report on the institution's largest credit exposure; the "Capital Adequacy Directive" (93/6/EEC) – applying the Basel capital adequacy requirements to investment firms and securities activities of banks; the "Deposit Guarantee Directive" (94/19/EEC) – aimed at protecting depositors against a loss of their deposits if their bank failed, assuming this to be a single, isolated event (Henderson, 1993; European Commission, 1997; Howells &

²⁶ Annex listing activities subject to mutual recognition in the Second Council Directive of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC (89/646/EEC).

Bain, 2002, pp. 450-452). Most of these directives were consolidated as a single text in Directive 2000/12/EC.²⁷

Effectively, the Second Banking Coordination Directive acknowledged that universal banking prevailed within the EU member states, especially Germany. The Second Banking Directive gave universal banks the right to undertake securities business in other EU member states, whereas non-banks, such as UK investment firms, did not enjoy the same rights. By stringently applying the home country control principle, banks were even allowed to carry out activities in the host country which were not covered by the host country's banking regulations.

Consequently, the British financial services industry, with its numerous investment houses, categorised as non-banks under European law, felt disadvantaged compared with its competitors with universal banking structures. British institutions argued that they could not benefit to the same extent from home country control and mutual recognition as some of the competing universal banks on the continent. In order to overcome this difficulty the Investment Services Directive (93/22/EEC) also applied the "single passport principle" to non-bank investment firms.

Following the Second Banking Coordination Directive, the varying capital requirements for different organisational forms of banking which existed across Europe also had to be addressed. In particular, since the securities operations of Germany's universal banks would compete with Britain's non-bank securities firms, there was a need to harmonise capital requirements. "If capital adequacy rules had not been extended to cover non-bank securities firms, then they, [...] would have been given a competitive advantage over banks engaged in securities business, which were required to meet capital adequacy rules" (Howells & Bain, 2000, p. 380).

²⁷ Directive 2000/12/EC consolidates the following Directives: 73/183/EEC on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions; 77/780/EEC, as amended by Directive 89/646/EEC, on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions; 89/299/EEC on the own funds of credit institutions; 89/646/EEC on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions; 89/647/EEC on a solvency ratio for credit institutions; 92/30/EEC on the supervision of credit institutions on a consolidated basis; 92/121/EEC on the monitoring and control of large exposures of credit institutions.

The Capital Adequacy Directive (CAD) of 1993 established uniform capital requirements which regulate functions instead of institutions. Therefore, the CAD applies to both universal banks' securities operations and non-bank securities firms. In practice, a universal bank identifies the trading positions of its balance sheet for which it needs to hold sufficient capital in accordance with the CAD. For the remaining assets, the bank provides capital as required by the 1989 Bank Solvency Ratio Directive, which is aligned with the 1988 Basle Accord.

The 1988 Basle Accord has been reviewed and the New Basel Capital Accord, often referred to as Basel II, became effective at the beginning of 2007 in the EU. Basel II comprises three aspects ("pillars"), namely (1) minimum capital requirements, (2) supervisory review of capital adequacy, and (3) public disclosure (Bank for International Settlements, 2003a). In essence, Basel II aligns a bank's regulatory capital requirements with its risks, leading to a more differentiated assessment of risk. Along with the review of the Basel Capital Accord (Basel II), the EU's capital framework was also revised as part of the Financial Services Action Plan (Howells & Bain, 2000, 2002; Dale, 1996).

Despite the major progress achieved with the Second Banking Coordination Directive and its ancillary directives, these measures could not remove all restrictions on the mobility of financial services. Exceptions to the home-country control principle persisted. For example, host countries could retain the right to control bank liquidity for monetary policy reasons. Furthermore, consumer protection remained a national icon. Banks selling consumer credit, savings and mortgages, still had to comply with local host-nation consumer protection rules and similar laws which served the "national public interest" (Henderson, 1993, pp. 23-25).

2.4.2.4. Financial Services Action Plan (COM(1999) 232)

In order to finally overcome these national obstacles and to reap the benefits of European Monetary Union (EMU) the Financial Services Action Plan (FSAP) was launched by the European Commission in 1999. Prior to the FSAP initiative, on 1 January 1994 Articles 67 to 73 of the Treaty of Rome were replaced by Articles 73b, c, d, e, f and g in anticipation of the imminent introduction of EMU. The amended Article 73 (b) identifies a common financial market as an objective in its own right, thus placing EU financial integration on the policymaking agenda. Article 73 (b) specifies that “within the framework of the provisions set out in this chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.” Moreover “[...] all restrictions on payments between Member States and between Member States and third countries shall be prohibited” (Article 73 (b), Treaty of Rome).

The Financial Services Action Plan comprised 43 measures to facilitate the emergence of a Single Market in financial services and ensure that the benefits of a common currency could be fully exploited by 2005. According to the European Commission’s plan, “the EU should be endowed with a legislative apparatus capable of responding to new regulatory challenges; any remaining capital market fragmentation should be eliminated, thereby reducing the cost of capital raised on EU markets; users and suppliers of financial services should be able to exploit freely the commercial opportunities offered by a single financial market, while benefiting from a high level of consumer protection; closer co-ordination of supervisory authorities should be encouraged; and an integrated EU infrastructure should be developed to underpin retail and wholesale financial transactions” (European Commission, 1999).

Under the FSAP, the European Commission also acknowledged that the greater interconnectedness of actors within the financial services sector required solutions which did not deal separately with the issues concerned. Consequently, the complexity of the FSAP package and the emergence of new challenges during implementation of the FSAP have given rise to calls for an FSAP II (Deutsche Bank Research, 2002; Bundesverband deutscher Banken, 2003).

2.4.3. Legal definition of a bank in the UK

Due to the differing legal traditions and national legal systems in Europe, definitions of what constitutes a “bank” also differ. Historically, the UK banking system featured a “considerable reliance upon self-regulation by the institutions concerned,” (Swary & Topf, 1992, p. 4) with very little formal regulation, mandatory rules, or prescribed codes, according to the principle of common law (Mastropasqua, 1978, p. 81).

Until the 1980s the British banking system featured a dual structure with clearing banks as “deposit banks” and merchant banks as “accepting houses”²⁸ (Mastropasqua, 1978, p. 87). Although there was no legal requirement for a statutory separation of the banking and securities industries, even the Bank of England officially distinguished between clearing and merchant banks as a matter of custom (Dale, 1992, p. 106; Artis, ed., 1992, pp. 81-91). Most merchant banks were established in the 18th and 19th centuries to finance international trade by the British Empire, although most merchant banks were actually founded by families who had their roots on the European continent, predominantly in Germany. Some of the most prominent families were Kleinwort, Rothschild, Schröder, and Warburg (Stechow, 1973; Chapman, 1984).

In the UK, the first broadly defined supervisory framework was set up by the Bank of England in 1974 (Steffens, 1990). In response to the European Commission’s First Banking Directive of 1977, the United Kingdom introduced the 1979 Banking Act (Butt Philip, 1982, p. 463), which required banks to apply for authorisation to the Bank of England. A bank could then either receive authorisation as a “deposit taking institution” or fulfil the more stringent criteria for receiving authorisation as a “recognised bank”. For a bank to become a “recognised bank” it had to be examined by the Bank of England which would then acknowledge that the institution meets all conditions of being of “high reputation and standing in the financial community” (Clarotti, 1984, p. 204).

²⁸ The financing of commerce took place by “accepting” bills of exchange (Mastropasqua, 1978, p. 87).

In anticipation of the European Commission's Second Banking Directive (1989), Britain passed the 1986 Financial Services Act and the 1987 Banking Act. Based on the City's tradition of self-regulation the Financial Services Act of 1986 aimed to establish a flexible system of regulation, which enhanced the rights of individual investors (Steffens, 1990). Five self-regulatory organisations (SROs)²⁹ were set up with the Securities and Investments Board (SIB) as the designated agency, responsible for monitoring them. However, following the 1986 Financial Services Act it emerged that these SROs preferred to fulfil the function of lobbying entities than carry out their supervisory duties (Howells & Bain, 2000, p. 362-375).

The Financial Services Act also provided the Bank of England with greater regulatory powers for the UK wholesale markets in sterling, foreign exchange and gold bullion (Howells & Bain, 2000, p. 372). The Bank of England's supervisory powers were further strengthened by the 1987 Banking Act, which introduced tighter regulatory control. The 1987 Banking Act abolished the distinction between recognised banks and licensed deposit-taking institutions, which had been established by the Banking Act of 1979 (Howells & Bain, 2000, p. 370). Thus, the 1987 Banking Act established a single class of authorised institutions which had to comply with the same regulations and rules.

Following the Banking Act of 1987, the Bank of England produced numerous papers establishing prudential rules which had to be met in order to be granted a banking licence. The Banking Act also anticipated the European Commission's Large Exposures Directive of 1992, which requires banks to provide standardised information about its main lending exposures. Furthermore, the Banking Act of 1987 empowered the Bank of England "to veto acquisition of a shareholding of more than 15 per cent in an authorised institution" (Howells & Bain, 2000, p. 371).

The 1986 Financial Services Act and the 1987 Banking Act were accompanied by further regulatory changes relating to the London Stock Exchange (LSE). In order to avoid prosecution by the UK government under the Restrictive

²⁹ These five self-regulatory organisations were: AFBF (Association of Futures Brokers and Dealers); FIMBRA (Financial Intermediaries Managers and Brokers Regulatory Association); IMRO (Investment Managers Regulatory Organisation); LAUTRO (Life Assurance and Unit Trust Regulatory Organisation); TSA (The Securities Association) (Steffens, 1990).

Practices Act, the LSE ended the fixed commission rates charged by stockbrokers to clients. The new legislation allowed firms to operate as both brokers and market-makers (dual capacity) (Steffens, 1990; Dictionary of Finance and Banking, 1997). Moreover, the 1986 Building Societies Act allowed building societies to grant unsecured loans and to become limited liability companies, which subsequently led to the transformation of building societies into banks (Howells & Bain, 2002, pp. 78-80). These fundamental structural changes in 1986-87, along with the opening up of the LSE's membership to limited liability companies are often referred to as the Big Bang in Britain's financial services industry (Howells & Bain, 2000, p. 362-375).

Yet, even after the 1987 Banking Act the legal definition of a bank remained so vague that in 1988 the Review Committee on Banking Services Law, which had been appointed by HM Treasury, remarked that "no satisfactory definition of 'bank' (or, for that matter, 'banker') has yet been devised" (Review Committee on Banking Services Law, p. 6, chapter 2.03). The Committee further notes that "the Banking Act 1987, where one might have expected to find some authoritative and up-to-date definition of a "bank", chose to avoid the use of the term altogether" (Review Committee on Banking Services Law, p. 6, chapter 2.03).

In 1998, the Bank of England Act was passed, paving the way for Financial Services Authority (FSA), which was established on 1 June 1998, four years before Germany set up a similar supervisory authority. Following the 1998 Bank of England Act, the FSA took over the responsibility for the supervision of the banking system and wholesale money markets and for enforcing the relevant legislation from the Bank of England (Howells & Bain, 2000).

In 2003 the FSA, HM Treasury and the Bank of England produced a joint consultation paper, which provided the basis for a "Financial Groups Directive". This paper addressed the "bancassurance" issue and introduced the legal term of a "financial conglomerate" which were implemented in the FSA Handbook and HM Treasury Regulations (HM Treasury & Financial Services Authority, 2003). This consultation paper demonstrated once again that the UK is clearly the country which sets the standards and thus leads the way in financial regulatory matters in the EU. Although national financial regulatory issues are nowadays determined largely at EU level, the country

with the most advanced and up-to-date regulatory framework should be best positioned to shape the relevant EU legislation.

2.4.4. Legal definition of a bank in Germany

By contrast to the British common law system, the German tradition of statute law produced a detailed Banking Act, the Gesetz über das Kreditwesen (KWG). This provides a precise legal definition of a bank and comprehensive rules about the activities of a bank. Bank supervision in Germany dates back to 1931 when it was institutionalised after the collapse of Danatbank, which triggered a banking crisis (Hartmann-Wendels et al., 2000, p. 342).

The present German Banking Act has been revised and amended six times since it came into force in 1962. With the exception of the EU's First Banking Directive on Coordination of Regulations Governing Credit Institutions of 1977, which did not require any legal changes, most of these amendments aligned German banking law to EU legislation. The third review of the German Banking Act in 1984 transformed the EU Directive on the Supervision of Credit Institutions on a Consolidated Basis of 1983 into German law. The fourth review in 1992 incorporated the EU's Own Funds Directive (1989) and the Second Banking Coordination Directive (1989). The fifth review of 1995 took into account the EU's Large Exposures Directive (1992), while the sixth review in 1998 dealt with the Capital Adequacy Directive (CAD) of 1993.

Following the sixth review, the definition of banking business in Germany comprises "(1) the acceptance of funds from others as deposits or of other repayable funds from the public unless the claim to repayment is securitised in the form of bearer or order debt certificates, irrespective of whether or not interest is paid (deposit business), (2) the granting of money loans and acceptance credits (lending business), (3) the purchase of bills of exchange and cheques (discount business), (4) the purchase and sale of financial instruments in the credit institution's own name for the account of others (principal broking services), (5) the safe custody and administration of securities for the account of others (safe custody business), (6) the business specified in section 1 of the Act on Investment Companies (Gesetz über Kapitalanlagegesellschaften) (investment fund business), (7) the incurrance of the obligation to acquire claims in respect of loans prior to their maturity, (8) the assumption of guarantees and other warranties on behalf of others (guarantee business), (9) the execution of cashless payment and clearing operations (giro business), (10) the purchase of financial instruments at the

credit institution's own risk for placing in the market or the assumption of equivalent guarantees (underwriting business), (11) the issuance and administration of electronic money (e-money business)" (§1, Paragraph. 1, Sentence 2, KWG).

Until May 2002 the Office for Banking Supervision (Bundesaufsichtsamt für das Kreditwesen, abbreviated to BAKred) was the principal regulatory authority (supported by the Bundesbank). It monitored the banks' compliance with banking law (KWG). Partly as a result of the acquisition of Dresdner Bank by Allianz, the insurance group, in 2001 a new single state regulator for the financial services industry was set up in May 2002, four years after Britain had set up the FSA. The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin) was established, in order to reflect the closer cooperation between banks and insurance companies. At both national and European level, the emergence of bancassurance concepts challenges the legal definition of a bank and, with it, banking regulation. According to Germany's BaFin "the trend towards integrated bancassurance groups is expected to continue."³⁰ Moreover, a growing number of companies in Germany and Britain with core businesses outside the financial services industry offer traditional banking and insurance services (White, 1998, p. 12).³¹

The new German Financial Regulatory Authority (BaFin) mirrors the structure of its British counterpart, the FSA. The functions of the former offices for banking supervision (Bundesaufsichtsamt für das Kreditwesen, BAKred), insurance supervision (Bundesaufsichtsamt für das Versicherungswesen, BAV) and securities supervision (Bundesaufsichtsamt für den Wertpapierhandel, BAWe) have been combined in BaFin, which now covers all key aspects of consumer protection and solvency supervision in the financial services sector. It can be expected that an EU-wide financial services authority will be set up in the near future, modelled on the basis of the FSA and BaFin. Presumably, this new supra-national regulatory body will draw substantially on the more experienced FSA, rather than on its four-year younger counterpart, BaFin. Consequently, the UK will probably have a greater say in devising this pan-European regulatory authority.

³⁰ BaFin - Federal Financial Supervisory Authority; Available from: http://www.bafin.de/index_e.htm. [Accessed 15 November 2003].

³¹ For example, around 15% of Volkswagen's 2002 operating profit originated from financial services (Volkswagen AG, Annual Accounts 2002, p. 99).

Comparing the evolution of British and German financial regulation, it may be concluded that Britain has overtaken Germany as the leader in EU financial regulatory issues. While in the 1970s Britain still had to catch up with developments in EU financial regulation, namely the First Banking Directive, which was implemented through the 1979 Banking Act, it has been spearheading EU financial regulation since the mid 1980s. This is best illustrated by Britain's Banking Act of 1987, which anticipated the EU's Second Banking Directive of 1989, and the early establishment of the Financial Services Authority, which recognised the functional integration of financial services firms.

By contrast, Germany seems to have fallen behind since 1980s, occupying the position of a follower rather than a leader in the formulation of financial regulatory policies at EU level. Along with the continuous decline in German banks' profitability, the country does not seem to anticipate regulatory developments and thereby lacks clout in formulating EU policies. While it did not have to amend its law following the EU's First Banking Directive it took the German authorities three years to implement the Second Banking Directive - five years longer than its British counterparts.

It could be conjectured that a clear legal definition of a bank and other financial terms as found in German law could impede the flexibility which appears necessary in the face of the ever faster changes in economic reality. Therefore, the much deplored absence of a clear definition of a bank in the UK and the tradition of common law (see previous remarks by the Review Committee on Banking Services Law) may have contributed significantly to the faster adaptability of the British authorities. Whichever legal system seems to better adjust to the fast changing economic reality, either tends to react to economic reality, although its reactions may in return have repercussions for that economic reality. Thus, an economic definition of a bank should be applicable across borders. The next section outlines the widely accepted microeconomic definition of a bank.

2.4.5. Microeconomic definition of a bank

The preceding sections showed that the varying banking traditions in Britain and Germany prompted different organisational structures in the banking sector. While in the UK a dual structure with clearing banks (deposit-taking institutions) and merchant banks (non-deposit-taking institutions) prevailed for many years, banks in Germany have traditionally been organised as universal banks. One important issue which emerges from these different organisational forms are the capital adequacy requirements for investment banks and retail banks. The different capital requirements for different types of banks pinpoint the most prominent aspect of banking business, namely dealing with risk, which is defined as the deviation from the expected, i.e. the variance of possible outcomes (Black, 1997, pp. 406-409).³²

Investment banks assist third parties in the management of risk. The bulk of an investment bank's revenues comprise non-interest income, such as commission fees and trading results, which are not determined by its balance sheet structure. In contrast, a retail bank takes risk on its own books, by granting loans, accepting deposits and settling payments. Thus, a retail bank's balance sheet varies with the scope of its operating business. Loans provided by a bank are shown on the asset side of the balance sheet, while deposits are shown on the liability side. A retail bank's principal revenue comes from charging more interest on its loans than it pays for deposits, leaving it with net interest income.

Building on the arguments put forward by Stucken (1957), Büschgen proposes that a microeconomic definition of a bank should follow a functional approach, in other words, that a bank should be categorised according to the services it provides to its clients. Therefore, a bank's assets, liabilities, and income statement³³ provide the structure for a microeconomic definition of a bank (Büschgen, 1998, pp. 33). This view is shared by Hartmann-Wendels et al., who maintain that a functional approach facilitates the analysis of a bank in its competitive environment (Hartmann-Wendels et al., 2000, p. 2). For this reason, the analysis of a bank's balance sheet and profit and loss account

³² Risk assessment is conditioned by the quality and quantity of information available at a time.

³³ Throughout this research the terms "profit and loss account" and "income statement" are used interchangeably.

represents one important method of evaluating banking strategies in this research.

For the purpose of this research, the microeconomic definition of a bank comprises the institution's balance sheet and income statement. This is of importance insofar as it facilitates the analysis of the pre-eminent strategic question as to whether and if so how a bank should offer advice on transaction services, or whether it should merely focus on intermediary functions. The strategic considerations are discussed at great length in chapter three. However, it is necessary to address the underlying concepts of intermediation at this stage to ensure a better understanding of disintermediation. Broadly speaking there are two explanations put forward why banks exist as financial intermediaries (Bhattacharya et al., 1998, p. 747). One approach emphasises the asset side of the balance sheet, while the other emphasises the liability side.

The explanatory models which focus on the asset side ("loans") regard "delegated monitoring" (Diamond, 1984) as a bank's primary function, i.e. a bank monitors an investment project on behalf of investors. According to Diamond, a bank takes on the role of a financial intermediary as it can deal more efficiently with information asymmetry than an investor/lender that provides capital directly to the borrower (Diamond, 1984, pp.393-414; Diamond, 1996, pp.51-66). Benefiting from the "law of large numbers", diversification and certain incentives allow a bank, as a financial intermediary, to better monitor and thus minimise the risk of loan losses than a single lender could do. Moreover Bhattacharya et al. explain that alternatively, depositors, that is to say investors, could only invest in large and undiversified stakes (Leland & Pyle, 1977; Diamond, 1984; Ramakrishnan & Thakor, 1984; Boyd & Prescott, 1986; Allen, 1990; Bhattacharya et al., 1998). Consequently, lenders, i.e. depositors, accept a lower return on capital in return for the risk-sharing service provided by the intermediary (Diamond, 1984, pp.393-414; Diamond, 1996, pp.51-66).

The models which explain the existence of banks by focusing on the liability side of the bank's balance sheet ("deposits") argue that there are investors, i.e. depositors, who are risk averse, uncertain about their future consumption plans and require a safekeeping place for cash (Diamond & Dybvig, 1983;

Bhattacharya et al., 1998, p. 747). Bhattacharya et al. concisely summarise the “liability-side” paradigm: “[...] Investors can invest their date 0 endowments in illiquid technologies that will pay off at date 2. Without an intermediary, all investors are locked into illiquid long-term investments that yield high payoffs only to those who consume late (date 2); those who consume early (date 1) get very low payoffs because early consumption requires premature liquidation of long-term investments. Improved risk sharing and thus ex ante welfare are attained by an intermediary that promises investors a higher payoff for early consumption and a lower payoff for late consumption, relative to the non-intermediated case” (Bhattacharya et al., 1998, p. 747).

Both explanatory paradigms have in common that banks are undeniably subject to macroeconomic developments. As highlighted in the introductory remarks to this chapter, banks represent an important link between microeconomic and macroeconomic development of an economy. Following this logic, the macroeconomic definition of a bank cannot be entirely disconnected from the microeconomic understanding (Büschgen, 1998, pp. 34). The concept of risk-sharing links a bank’s balance sheet with the macroeconomy. According to Büschgen, only those financial intermediaries who also take some risks themselves and transform such risks should be classified as “banks” in a macroeconomic context (Büschgen, 1998, pp. 34-41). An inadvertent result of the banks’ transformation activities is that they also fulfil the important function of liquidity providers to the economy.

2.4.6. Macroeconomic definition of a bank

The macroeconomic definition of a bank is derived from the macroeconomic consequences of the workings of a bank's balance sheet and the aggregate balance sheets of the banking sector in a defined region. Merely performing the function of a financial intermediary by facilitating transactions is therefore a necessary, but not a sufficient, condition for a macroeconomic definition of a bank (Büschgen, 1998, pp. 34-38).

The transaction process deals with the asymmetric information available to market participants. Benefiting from economies of scale and scope, banks can reduce information-related costs and match demand and supply for capital (Büschgen, 1998, pp. 36-38). By channelling funds from economic actors who have a surplus to their current needs to those who have a deficit, banks increase market efficiency and facilitate the allocation process.

However, financial intermediation in the narrow sense comprises transformation functions in addition to transaction functions. The transformation process performed by banks means that banks themselves enter into contractual agreements with other market participants and change the size, maturity and risk structure of the underlying financial contracts. Only by providing transaction and transformation services does a financial intermediary meet the necessary and sufficient conditions for a macroeconomic definition of a bank (Büschgen, 1998, p. 39).

Under this ("narrow") macroeconomic definition an investment bank would not be classed as a "bank" since it usually only carries out transactions but not transformation. The transactions carried out by an investment bank are not reflected on its balance sheet, so such deals also do not have any repercussions for the economy's money supply. By contrast, money supply is a function of banks' lending and deposit policies. By transforming deposits into loans these institutions are intrinsically linked to an economy's monetary mechanism.

As noted by Büschgen, this narrow macroeconomic definition of a bank is challenged by ongoing disintermediation, whereby those market participants that demand capital make direct arrangements with providers of capital

(Büschgen, 1998, pp. 41). The process of disintermediation has been facilitated by improved information technology, greater corporate transparency and more differentiated risk-analysis tools. Consequently, transaction services, as provided by “investment banks”, gradually substitute transformation services.

Although the trend towards disintermediation might continue, financial intermediation in the sense of transformation services is likely to dominate the banking activities for the near future. Because of banks' asset-liability mismatch, which results from their transformation tasks, they are relatively more sensitive to the business cycle than other firms. Thus, competition policies for this sector should reflect the greater sensitivity of banks and their pivotal position in the economy (Carletti & Hartmann, 2002).

According to economic theory, profitability declines as competition increases. This leads to the question of how competitive the (“vulnerable”) banking sector could become without weakening the actors to such an extent that the overall stability of the banking system is put at risk. Extremely tough competition could, for example, encourage banks to take high risks on inappropriate (wrongly priced) conditions, which would eventually have a detrimental effect on profitability.³⁴

Despite ample research into the linkage between banking competition and systemic stability, it appears that there is no prevailing academic view on how the dynamics of competition and banking stability might work. A comprehensive literature review of the theoretical and empirical research on the links between banking competition and the stability of the financial system by Carletti and Hartmann cautiously concludes: “the idea that competition is something dangerous in the banking sector, since it generally causes instability, can be dismissed” (Carletti & Hartmann, 2002, p. 32).

Carletti and Hartmann also point out that competition policies generally refer to three different types of business practices: cartels, abuse of a dominant position and mergers, whereby mergers are only of concern if the newly formed entity would have a dominant position (Carletti & Hartmann, 2002, p. 9). Further they note that the fragmented banking market in most countries

suggests, that “cartels” and “mergers” play a greater role in Europe than “abuses of dominant position” (Carletti & Hartmann, 2002, p. 9). Mergers and acquisitions (M&A) among banks/financial institutions as part of their corporate strategy are discussed in chapter three of this thesis. At this stage, the analysis of banks’ M&A activities is only of relevance insofar as it touches upon the issues of competition and antitrust policies³⁵ and therefore contributes to a macroeconomic definition of a bank.

³⁴ High risk -provisioning burdens the bank's profit and loss account.

³⁵ Articles 85 and 86 of the Treaty of Rome, which protect competition in the European market, should have been applied to the banking industry right from the outset of the European project. However, in practice the European Commission considered the banking sector as a national icon which remained somehow “special” until a ruling of the European Court of Justice in 1981 also applied Article 85 to the banking sector (European Court of Justice, Gerhard Züchner vs. Bayrische Vereinsbank AG; Carletti & Hartmann, 2002, p. 38). Although Germany was among the first Western European countries to adopt a full-scale competition law in 1958 (Gesetz gegen Wettbewerbsbeschränkungen, GWB), it still explicitly stated that the banking and insurance sectors were subject to “special” rules (Carletti & Hartmann, 2002, p. 38).

2.4.7. Mergers & acquisitions in banking – a macro-force

In the late 1960s and 1970s governments were still identified as the powers impeding the formation of an integrated European banking market. As noted by Kirschen in 1969, the governments of the Community “are reluctant to lose control over their nationally chartered, revenue-producing corporations. Consequently, international mergers have not been encouraged” (Kirschen, 1969, p. xii). In the same vein, Butt Philip argued in 1978 that “the integration of financial practices has not been matched by integration of financial institutions, both because of the very substantial historic institutional differences that still thrive in the financial world, and because governments and the institutions themselves have not been in any great hurry to bring down the barriers” (Butt Philip, 1978, p. 319).

With the commitment to create a Single European Market the focus shifted towards the underlying structural challenges of integrating the European banking market. Yet, it has been remarked that even the 1989 Second Banking Directive “preserves a relatively large degree of discretion to national supervisory authorities in the EU to block bank mergers” (Carletti & Hartmann, 2002, p. 30). National authorities can express their concern, for example, about possible conflicts of interest, capital adequacy, organisational structure and the commercial rationale of a transaction (Carletti & Hartmann, 2002, p. 39).

Hurst, Perée, and Fischbach point out that the scope for possible cross-border banking consolidation in Europe had been limited as long as the EU member states maintained their monetary sovereignty since exposure to different currency areas represents a risk factor³⁶ for banks (Hurst, Perée & Fischbach, 1999, p. 85). It was expected that the consolidation process among banks would gain momentum following the introduction of the euro. Schmidt, among others, has suggested that the number of banks in Europe will decline due to mergers and acquisitions (Schmidt, 2001, p. 16). Eijffinger and de Haan also contend that “take-overs associated with the transition to the monetary union indicates that the restructuring of the European banking sector is far from finished” (Eijffinger, & de Haan, 2000, p. 160-162).

³⁶ Banks can insure against this currency risk with hedges, which however reduce the profit margin.

One way of addressing the European consolidation process among banks is to analyse the changing balance sheet structures following EMU. The asset side of a bank's balance sheet, i.e. essentially its loan portfolio, could be further diversified as it seems plausible that a bank improves its risk management by identifying countries which demonstrate a low degree of correlation with their domestic portfolio. However, broadening the liabilities side of the bank sheet depends on successful pan-European expansion of its retail banking activities.

According to Buch and Heinrich there are two reasons for changes in the ratio of the banks' foreign assets and liabilities to GDP: (a) the openness of the financial system and (b) the importance of the banking system relative to GDP (Buch & Heinrich, 2002, pp. 6-7). Given that the EU financial market is legally "open", the absence of major cross-border mergers among banks could be seen as a separate and therefore third reason for the prevailing national asset and liability structures.

Buch and Lapp's research (Buch & Lapp, 2000; Lapp, 2001) on the diversification of European banks' asset holdings concludes: "diversification within Europe is not necessarily an optimal strategy" (Buch & Heinrich, 2002, pp. 6-7). Building their argument on the capital asset pricing model (CAPM), they argue that the similarity of EU economies and the further convergence of these economies as result of monetary integration do not significantly increase diversification opportunities.³⁷

The analysis by Buch and Heinrich suggests that the limited diversification opportunities across Europe are one reason for the few cross-border takeovers or mergers among European banks, although Hurst, Perrée and Fischbach point out that risk management is one of the reasons cited least by management for a merger (Hurst, Perée & Fischbach, 1999, p. 96). A survey by the IMF, BIS and OECD supports this argument as it identifies cost savings and revenue growth as the primary motives for financial consolidation, while nowhere is there mention of improved risk management (Group of Ten, 2001).

³⁷ It is worth noting that their analysis also revealed that German banks were insufficiently diversified (Buch & Heinrich, 2002, pp. 6-7).

Another way of addressing the European M&A process among banks is to question the impact of consolidation on their aggregated income statements. Given the high fixed costs in banking and the information and distribution-intensive nature of the financial services industry, consolidation among banks may also be motivated by economies of scale and scope (Eijffinger, & de Haan, 2000, p. 160-162). However, as highlighted by Eijffinger and de Haan and corroborated by research from Walter (1999), Berger, Demsetz, and Strahan (1999) and Vander Venet (1998), there is some evidence that mergers of banks can also lead to diseconomies of scale. This may result, for example, from the difficulty to manage the newly emerged complexity and a disproportionate increase in administrative fix-costs, which cannot be sufficiently fast reduced (Walter, 1999).

Eijffinger and de Haan subscribe to the theory that the acquiring bank targets a bank with low profitability and relative inefficiency, which will then be turned around and “upgraded” (Eijffinger, & de Haan, 2000, p. 162). This argument might hold true for acquisition targets, which are significantly smaller than the buyer, but they would only offer limited opportunities to benefit from economies of scale. Yet, if the acquisition target is of significant size relative to the acquirer, then the acquisition can raise concerns among the owners of the acquiring bank about the feasibility of the turnaround strategy.

Chapter three discusses the various considerations for and against mergers and acquisitions as part of a bank’s corporate strategy. Whether a bank pursues a “make” or “buy” strategy depends largely on the opportunities available and prevailing circumstances, thus also on the existing market structure. Although little can be said about the link between competition and banking stability, it should be highlighted that all the policy measures which opened up the European financial markets leave the decision on whether or not to merge with the banks themselves, widening their strategic spectrum. Therefore, it may be postulated that this greater choice is one obvious benefit of an integrating European financial system. The next section concludes this chapter by considering some of the benefits, disadvantages and challenges of financial integration.

2.5. Expectations at the outset of the European Common Market and concluding remarks on the benefits of integrating financial systems

According to the preceding analysis, a financial system is a subsystem of an economy consisting of various financial markets and institutions. Therefore, the integration of financial systems is often part of a wider economic integration process, comprising the removal of barriers to the free movement of goods, services, factors of production and money (Swann, 1995, p. 103). The removal of these barriers can have mutually reinforcing effects, so that, for example, financial integration may also promote integration in other economic areas. Consequently, a larger degree of financial integration also facilitates trade between the integrating partners, while more trade requires a more highly integrated financial system.

Tinbergen differentiates between positive and negative integration (Tinbergen, 1954), whereby “negative integration” refers to policy measures which imply the removal of laws and rules that maintain discrimination on national grounds. Thus, negative integration calls for a joint policy by nation states to gradually curtail the national dominance of policies and laws. If additionally, common market institutions with exclusive powers are set up, then the term “positive integration” is used (Tinbergen, 1954). Accordingly, positive integration stands for the devolution of power to jointly established institutions that apply policies equally to all member states.

In economic theory the principal rationale for economic integration is to increase economic welfare through trade. It is argued that economic integration enhances an economy's welfare if it leads to more “trade creation” than “trade diversion”, i.e. if it increases net trade creation (Viner, 1950). Trade creation is defined as a “shift from domestic to partner country sources of supply” (Balassa, 1991, p. 177), whereby domestic high-cost sources are substituted by low-cost imports from associated countries.

By contrast, trade diversion takes place if low-cost imports from non-member countries are replaced by high-cost imports from the member states in a free trade area. This would result in a welfare cost which is either borne by

exporters in third countries or by consumers within the free trade area. Due to these possible welfare costs, it is a primary concern of the European Commission that the Common Market should lead to more trade creation than trade diversion which would be reflected in price declines (Viner, 1950; Lipsey, 1957; Lipsey, 1960; Balassa, 1991). Furthermore, economic integration may lead to economies of scale and scope and spur efficiency through greater competition.

In accordance with this reasoning, the economic benefits of a European Common Market are essentially threefold: first, an increase in net trade creation, thus optimising the allocation of resources within the European Union; second, economies of scale leading to increased competition and therefore to greater efficiency across the Common Market; third, higher investments within and outside the European Union (Howells & Bain, 2002, pp. 442).³⁸

In order to quantify the economic benefits of an integrated European market, several research projects were initiated by the European Commission, three of which are reviewed briefly in the following paragraphs. The first and most widely discussed is a study carried out under the auspices of Paolo Cecchini entitled the “Cost of Non-Europe” (Cecchini, 1988). The “Cecchini Report” concluded that the single-market programme would have a major macroeconomic impact, increasing the EU’s (at the time EC’s) GDP by approximately 4.5% and reducing consumer prices by 6.1%, while boosting employment by 1.5% by creating 1.8 million new jobs in the medium term (Cecchini, 1988, p. 97). Of this potential increment to GDP, 1.5% was attributed to the liberalisation of financial services (Cecchini, 1988, p. 98).

The report analysed the financial services sector in eight³⁹ member states, among them the UK and Germany, and distinguished between banking, insurance and securities. Europe’s consumers, in particular, were expected to benefit from a 10% fall of prices for retail financial services (Cecchini, 1988, p. 42; Howells & Bain, 2002, pp. 447). Cecchini forecasted significant price declines in Belgium, France, Italy and Spain and identified the largest price

³⁸ For a literature review on economic integration see for example Balassa (Balassa, 1991) or Pelkmans (Pelkmans, 2001).

³⁹ The countries are Spain, Italy, France, Belgium, Germany, Luxembourg, UK and the Netherlands.

differences in motor vehicle insurance, home loans, consumer credit, foreign exchange drafts and securities operations (Cecchini, 1988, pp. 38-39).

Four economic effects of liberalising the financial services market are highlighted in the Cecchini Report: 1. lower prices for financial services; 2. more efficient allocation of capital and therefore lower cost of capital; 3. access to a wider range of markets, instruments and services; 4. overall greater economic efficiency since financial services are a major input factor into the industry (Cecchini, 1988, p. 95; Howells & Bain, 2002, pp. 447).

The Cecchini Report has been severely criticised for its questionable methodology, which suggests a precise quantification of potential benefits based on price differentials between member states (Llewellyn, 1992, p. 138). Concerning the financial services industry, the critiques argue that the measurement of price differences between countries, which unrealistically assumed standardised products, ignored regional risk differences. Moreover, the Cecchini Report concluded that different prices principally originate from the absence of competition, without taking into account systemic inefficiencies caused by varying national tax, regulatory and legal conditions (Howells & Bain, 2002, pp. 447-448).

As noted by Howells and Bain (Howells & Bain, 2002, pp. 448), the report also presumed that the European Common Market would trigger competitive forces in financial systems. However, more than a decade after the creation of the European Common Market it seems that the embeddedness of financial services may have impeded the adaptation process (Hackethal & Tyrell, 1998; Hackethal & Schmidt, 2000; Schmidt 2001). High entry costs, the difficulty of realising transnational economies of scale and imperfect information tend to further cement the fragmented structures and leave markets, at least, retail banking markets, nationally segmented.

In the 1996 Single Market Review, the European Commission presented a series of 39 studies, which assessed the progress made in implementing the Single Market Programme. Mario Monti, European Commissioner for Internal Market & Services at the time, conceded that the Single Market project did not lead to “a sharp downward convergence of the prices of corporate, retail and mortgage loans across the EU, as had been hoped for” (Monti, 1996, p. 62).

The findings of the 1996 Single Market Review show that only in the cases of credit cards and mortgages has the price spread narrowed since the Cecchini Report was published in 1987 (Monti, 1996, p. 63).

However, the European Commission emphasised in its sobering assessment that the European Common Market has enabled European banks to develop a stronger capital base through the Own Funds Directive (89/299/EEC), the Solvency Ratio Directive (89/647/EEC) and the Directive on Deposit Guarantee Schemes (94/19/EEC) (Monti, 1996, pp. 62-63; European Commission, 1997, p. 6). These directives followed the international requirements of the 1988 Basle Capital Accord.

Furthermore, the Single Market Review holds that banks “preferred not to compete on the price of lending” (Monti, 1996, p. 66) but rather competed on the range of products and quality of service. It is also pointed out by the European Commission that banks have become more competitive and international in their operations and alliances, with the universal banking model emerging as the “norm” across EU markets (Monti, 1996, pp. 62-63; European Commission, 1997, pp. 6-7).

Mario Monti concluded that “the single market’s impact on banking has been positive but not startling” (Monti, 1996, p. 67). He recognised that different tax regimes are the principal barrier to further integration and pinned his hopes on the European monetary union, which appeared necessary for the integration process to gain momentum and for banks to realise further economies of scale and scope (Monti, 1996, p. 67).

Two more research projects prepared for the European Commission are the report by London Economics (London Economics et al., 2002) and the analysis by two German think tanks, the Zentrum für Europäische Wirtschaftsforschung, Mannheim (ZEW), and the Institut für Europäische Politik, Berlin (IEP). The report by London Economics estimates that European financial integration has reduced the cost of capital, thus increasing the EU’s GDP by 1.1% (“in the long-run”). According to London Economics, the single most important factor in this 1.1% increase in European GDP is the reduced cost of equity finance, which accounts for 0.5%. Moreover, the study

forecasted that total employment will rise by 0.5% as a result from greater market liberalisation (London Economics et al., 2002).

The study by the ZEW and the IEP, better known as the Gyllenhammar⁴⁰ Report, focuses on the European retail market for financial services. Among the benefits of further financial integration, the report highlights the greater product choice for consumers, particularly in smaller countries, and falling prices for financial retail products. Furthermore, the research expects a more integrated financial retail market to result in substantially lower interest rates for private borrowers (Heinemann & Jopp, 2002).

Regarding the macroeconomic effects the Gyllenhammar Report draws on worldwide cross-country samples which suggest that greater financial integration between countries can increase the annual economic growth rate by 0.5% - 0.7% per year (Heinemann & Jopp, 2002, pp. 40-41). In contrast, to London Economics, this analysis cautions about quantifying the potential EU-wide effects on employment associated with more financial integration as national labour market conditions are a highly relevant and highly heterogeneous variable (Heinemann & Jopp, 2002, p. 42; Beckmann, et al. 2002a).

The Gyllenhammar Report also notes that “a number of obstacles impedes the development of unified financial retail markets in Europe”. Examples are differences in tax regimes and national consumer protection legislation (Heinemann & Jopp, 2002, p. 13). In addition to these aforementioned policy-induced obstacles the study notes that the numerous natural obstacles “like differences in language and culture can not realistically be addressed by national or European policymakers” (Heinemann & Jopp, 2002, p. 13, Beckmann, et al. 2002a, p. 11).

All three reports appear to essentially serve as policy tools or “ammunition” for politicians. The Cecchini Report clearly aimed at paving the way for the Single Market Project, while the reports by Gyllenhammar and London Economics should be seen in the context of the Financial Services Action Plan. In particular, the overly ambitious Cecchini Report, which covers a wide range of

⁴⁰ The report was prepared for the European Financial Services Round Table, chaired by Pehr G. Gyllenhammar, Chairman of CGNU (now Aviva, the UK insurance group).

industries, is a prime example of a large-scale research project which attempts too much and ultimately achieves very little. The experience with the Cecchini Report seems to have taught the European Commission to be less outspoken about quantifying the potential gains of economic integration.

Consequently, the statements and projections of the European Commission have become more general. The European Commission, for example, merely notes in the 2002 report by the Economic and Financial Committee (EFC) on EU financial integration that integrating financial systems enhances competition among financial services providers, promoting financial innovation and diversification (European Commission, 2002a, p. 10). Along with the increased liquidity and greater depth of capital markets, which allow better risk sharing, this should reduce the cost of capital while improving the rate of return for investors (European Commission, 2002a, p. 10).

These views by the European Commission are corroborated by research on financial integration and economic development that is not EU-specific. There is a broad range of academic literature arguing that financial development spurs investment and economic growth. For example, the works by Goldsmith (1969), King and Levine (1993a), King and Levine (1993b), Jayaratne and Strahan (1996), Rajan and Zingales (1998), Beck, Levine, and Loayza (2000a and 2000b), and a report by the World Bank (2001) offer some evidence that there is a positive correlation between aggregate economic growth and the level of development of financial intermediaries, stock market liquidity and the depth of financial markets. Essentially, these studies conclude that financial development promotes economic growth by reducing the costs of financial intermediation and that due to improved allocation of resources, the social marginal productivity of capital should rise and affect households' savings rate (Pagano, 1993; European Commission, 2002b, p. 7).

Building on these arguments the European Commission maintains that financial integration enhances financial development as it increases the competition among the financial intermediaries, thus improving the participants' efficiency (European Commission, 2002a, p. 12; Beckmann, et al. 2002a, p. 10). Furthermore, the pressure on national authorities to improve regulation (accounting standards, securities law, banking supervision, corporate governance) in order to align it with best-practice standards in the

integrating area illustrates how financial integration can advance financial systems via policy measures (European Commission, 2002a, p. 12; Beckmann, et al. 2002a, p. 10).

More specifically, the European Commission argues that “the tendency towards a “level playing field” in regulation is an essential pre-requisite of an integrated market, and it is reasonable to expect this convergence in regulatory standards to result in an improvement in the regulatory standards of less developed financial markets. This improvement may help promote their development, by reducing adverse selection and agency costs as well as the distortions induced by inadequate regulation” (European Commission, 2002b, p. 13).

Despite these benefits from European financial integration, it should be recalled that this integration process implies the transformation of formerly coherent financial systems, featuring national idiosyncrasies. As elaborated in this chapter, a financial system can be described as a configuration of several elements that complement each other (Hackethal & Tyrell, 1998; Hackethal & Schmidt, 2000; Schmidt 2001). This coherence, which contributes to the stability of a financial system, also poses a challenge for integrating national financial systems (Hackethal & Tyrell, 1998; Hackethal & Schmidt, 2000; Schmidt 2001).

Accordingly, the gradual convergence of different financial systems becomes a cumbersome undertaking since the similarity of only a few elements is not sufficient to transform the fundamental structure of a financial system (Schmidt, 2001, p. 21). Schmidt, who puts forward this idea, takes his argument even further by suggesting that a financial system might need to be “sufficiently destabilised” in order to change its structure (Schmidt, 2001, p. 21).

In the same vein, it is noted in the report by London Economics that financial integration is not necessarily synonymous with “frictionless financial markets”, (London Economics et al., 2002, pp. 12-13) although greater integration may lead to reduced friction in some areas. The report concluded that the friction in financial markets is inherent to the financial industry structure, and may not

disappear even if financial integration is fully achieved, thus affecting the functioning of financial markets (London Economics et al., 2002, pp. 12-13).

This transformation process primarily challenges the institutional pillars of the financial system, namely the banks. Banks as individual corporate entities need to adjust their strategic positioning sufficiently to enable them to benefit from this rapidly changing environment. In fact, one predominant strategic challenge comes with the widening and deepening of Europe's capital markets - that is the development towards more financial disintermediation, facilitated not least by rapid technological innovation. Additionally, banks need to respond to the dramatic demographic changes in most European countries. They should seize these and related challenges as strategic opportunities to increase stability and profitability.

As remarked by Cecchini in his report "the benefits expected from market integration will not appear at the wave of a wand. To bring them about many changes are needed, not least the gearing up of business strategies to meet the new market's greater challenges" (Cecchini, 1988, p. 86). Since banks are the pivotal institutions of financial systems, their corporate strategies mirror the interface between the micro and macroeconomic dynamics of financial integration. Therefore, the next chapter reviews strategic theories/concepts and discusses their applicability for banks in the context of European financial integration.

3. Corporate strategy analysis and applicability to the banking sector

3.1. Introduction

While the previous chapter outlined EU financial integration as the “playing field for banking strategies”, this chapter deals with the different schools of thought in strategic management and their applicability for the analysis of realised banking strategies in the context of European financial integration.

At the outset of this third chapter, the political and military roots of contemporary strategic thinking are elaborated. The relevance of literature on military-diplomatic strategy for modern corporate management is recognised by various contemporary management academics from different schools of thought (Quinn, 1980; Whittington, 1993; Mintzberg et al., 1998; Porter, 1998; Grant, 2002). Therefore, a concise *tour historique* should facilitate an understanding of what Whittington calls the “classical school” of strategic management (Whittington, 1993).¹

After reviewing the concept of “strategy” in its historical context, the different understandings of the contemporary term “strategy” in management studies are discussed. For this purpose, Mintzberg’s heuristic distinction between five definitions of “strategy” – as plan, ploy, pattern, position, and perspective – should help to structure the debate about the implicitly different usages of “strategy” (Mintzberg, 1987, 1998).

Since the origins of modern management strategy in the 1950s, publications by academics and practitioners have fuelled and constantly broadened the debate about strategic management – not least because of the field’s proximity to business reality. Numerous approaches to the study of strategic management, such as the cultural school, which sees strategy as a collective process glued together and driven by culture, or the cognitive school, which considers strategy to be a mental process, are not directly considered

¹ The early “classical school” of management strategy was essentially established by the writings of Chandler (1962), Ansoff (1965, 1985), Sloan (1963), and was then refined by the work of Porter (1980,

(Mintzberg et al., 1998). Neither does this research take into account the vast leadership literature and the uncountable anecdotal evidence of successful businesses.

In order to deal with the voluminous literature² about strategic management and organisational theories³ (Mintzberg et al., 1998, p. 7), this research centres on two prominent schools of thought and assesses their theories in the context of the banking industry. First, it is considered how the structure of the banking industry drives banks' competitive behaviour and determines their profitability. This approach is rooted in industrial organisation economics and is closely associated with the works of Porter (Porter, 1979, 1980, 1985, 1998).

A critical discussion of Porter's five forces framework in the context of the banking industry then paves the way for an assessment of the resource-based view and the ideas put forward by Hamel and Prahalad (Hamel & Prahalad, 1989, 1990, 1993). According to Mintzberg (Mintzberg et al., 1998) the resource-based view should be seen in the tradition of policy analysis and the "learning school" (Lindblom, 1959, 1968, 1979; Cyert & March, 1963; Weick, 1969; Quinn, 1978, 1980a, 1980b, 1989). Brandenburger and Nalebuff's concept of co-opetition takes into account that buyers, suppliers, and producers of complementary products do not only interact as competitors, but may also work cooperatively with each other. A discussion of this game theoretical approach complements the review (Brandenburger & Nalebuff, 1996).

In comparison to the writings about general strategic management and finance/capital market theory, the literature on the management of banks is relatively scant (Süchting, 1992; Büschgen, 1993, 1998; Koch, 1995; Betge, 1996; Saunders, 1997; Freixas & Rochet, 1997; Hartmann-Wendels et al., 2000; Büschgen & Börner, 2003) and few authors combine the analysis of strategic management with the banking business (Canals, 1993, 1997, 1999; Grant 1992; Gardener & Molyneux, 1993; Walter, 1999; Börner, 2000; Smith &

1985) and to some extent also Ohmae (1983), all of whom were influenced by the military tradition of strategic thinking.

² Mintzberg suggests that in fact anything written about "collective systems of all kinds" could be the subject of a literature review on organisations and the strategic management process (Mintzberg et al., 1998, p. 7).

Walter, 2000, 2003; Gardener & Versluijs (eds.), 2001; Hackethal, 2001; Büschgen & Börner, 2003).

Some studies apply Porter's competitive framework to the banking industry (Ballarin, 1986; Gardener, 1990; Canals, 1993; Chan & Wong, 1999). On a theoretical level, Börner (Börner, 2000) derives an integrated concept that combines the positioning school and the resource-based view. Yet, there are various publications (e.g. Channon, 1988; Carmoy, 1990; Dixon, 1993)⁴ on changes in the banking landscape which use the term "strategy" merely as a catchword and do not elaborate on it, let alone, engage in a discussion that could somehow be embedded into the vibrant academic debate about strategic management.

One possible explanation for the exiguous literature on bank management is put forward by Büschgen and Börner (Büschgen & Börner, 2003, p. 1-3). They argue that finance and capital market theory purportedly provides sufficient explanation of banking operations, whereas general management concepts are considered adequate to account for the business/management aspects of a bank, leaving the intersection of these two fields under-researched. An additional reason could be that deductive methodologies dominate the largely quantitative approaches to finance and capital market theory, whereas the more qualitative studies of business management often apply inductive methodologies.⁵ Due to these different approaches and the broad range of academic fields, bank management in general and bank strategies in particular do not seem to be widely researched (Büschgen & Börner, 2003, p. 230).

Studying different aspects of the complex strategy process has led to the emergence of numerous strategic management theories, as illustrated by the different angles taken by Porter and by Hamel and Prahalad. According to Mintzberg, a strategy process comprises a number of aspects⁶ which are

³ According to Mintzberg, he and two colleagues reviewed some 2,000 books and articles on strategic management over the years, which only represent the prominent academic literature (Mintzberg et al., 1998, pp. 7-8).

⁴ Often these authors have an implicit understanding of "strategy", which is in the tradition of the "classical school" (Whittington, 1993), i.e. the design/planning/positioning schools.

⁵ It seems that the tradition of quantitative approaches to the study of business economics (Betriebswirtschaftslehre) at German universities has fostered a climate in which research on banking (Bankbetriebslehre) is more common than at Anglo-Saxon academic institutions.

⁶ Such as learning, power, the environment, leadership skills, vision, corporate culture, tactics, planning and various mental and social aspects (Mintzberg et al., 1998).

analysed by different schools (Mintzberg et al., 1998, p. 367). This research recognises that most of these contributions do not appear to be mutually exclusive. In fact, most paradigms should be regarded as complementary concepts (Mintzberg et al., 1998; Börner, 2000). Acknowledging that strategy is more than just the outcome of planning and positioning, in other words that it is the result of a multitude of ingredients, does not obviate the need for rational analysis of realised strategies. According to Grant there can be little doubt as to the importance of systematic analysis as a vital input into the strategy process - regardless whether strategy formulation is formal or informal and whether strategies are deliberate or emergent (Grant, 2002, p. 27).

Following the terminological clarification of strategy, this chapter discusses Porter's strategic management theory as well as Hamel and Prahalad's resource-based views in the context of the banking industry. However, as none of these strategic management theories is grounded in the banking sector, a straightforward application to banking remains hampered. Therefore, a theory that is grounded in the banking industry through empirical research may provide a better basis for understanding the strategic issues of specific relevance to banks. The final part of this chapter refers back to the underlying question of the banks' position between micro and macro structure and paves the way for the next chapter, which looks at the methodology used in this research.

3.2. Strategy analysis in its historical context

Contemporary strategic management gradually emerged as a management discipline in its own right during the late 1950s and early 1960s and is closely associated with the names of Alfred Chandler, Igor Ansoff and Peter Drucker. Yet, the documented beginnings of strategic thinking can be found in the tradition of military analysis, which dates back some 2,500 years (Evered, 1983; Liddell Hart, 1991; Whittington, 1993). Whittington observes that “even today, when business strategy can claim a substantial and independent body of experience, military imagery continues to influence contemporary strategy analysis [...]” (Whittington, 1993, p. 15).

Military strategy differs in essence from management strategy only insofar as it is less restricted in applying specific means to achieve certain ends. In both cases, strategy revolves around realising conditions which are perceived as preferable to the status quo. Appraising the long-standing tradition of military strategy analysis could serve two purposes in the analysis of banking strategies in the context of European financial integration.

First, military strategy appears to have developed a more distinct understanding of what actually constitutes strategy, in contrast to tactics and stratagems, than contemporary management strategy – a distinction which may also assist in identifying what is strategy as opposed to what is *not* strategy in the corporate world. If there are companies with strategies, logically there must also be companies without strategies, regardless whether the companies with strategies succeed or not.

Second, the previous chapter should have adequately illustrated how banks contribute to the functioning of national economies and consequently also serve as political instruments - not least, as elaborated, these institutions can pose a major threat to economic and political stability. When, some two hundred years ago, the Prussian military strategist Carl von Clausewitz (1780-1831) formulated his dictum that war is nothing but a continuation of political activity by other means, he also remarked that next to military power economic conflicts can resemble wars (Clausewitz, 1997, book III, chapter I, 4, p. 148). Therefore, it may be postulated that commercial conflicts are a continuation of

politics by other means, which puts contemporary strategic management into the light of contributions made by military strategists.

The first documented strategic treatise is the "Art of War", written around 500 B.C. by Sun Zi Bingfa, better known as Sun Tzu (Master Sun) (Sun Tzu, 1963; Senger, 2002, p. 46). Sun Tzu developed thirteen basic principles⁷ about the art of war, which laid the foundations for the professional science of warfare (Sun Tzu, 1963). Sun Tzu's text was well known by Chinese emperors and military leaders for many centuries and arrived in Europe in the late 18th century through a French missionary who translated it into French, so Napoleon Bonaparte possibly knew the text as "L'Art de la Guerre" (Stahel, 2003, p. 221).

Around hundred years after Sun Tzu, the Greek author Aeneas Tacticus (4th century B.C.) wrote also a book on strategy (Stahel, 2003). The word "strategy" is derived from the Greek word "strategia", meaning "generalship"⁸ (Duden Band 7, 1963; Grant, 2002, p. 16). At the time, the strategoi were the ten highest military officers in Athens (Stahel, 2003, p. 37). Several other Greek statesmen, officers and philosophers dealt extensively with strategic questions during this period. For a review of the early Greek military strategy tradition see Goldschmidt (1960).⁹

Sun Tzu and various Greek strategists put forward the idea of what contemporary Swiss military strategist¹⁰ Stahel calls "indirect strategy" (Stahel, 2003). Indirect strategy is defined as achieving victory without military violence, which enables the winning party to capture everything in "one piece" (Sun Tzu, 1963, p. 77; Stahel, 2003, pp. 19-35). Therefore, indirect strategies are largely based on deception and stratagems. In contrast, direct strategies essentially employ the power of armed forces (Stahel, 2003, p. 19) and aim at the complete annihilation of the enemy.

⁷ These thirteen basic principles are: 1. Estimates; 2. Waging War; 3. Offensive Strategy; 4. Dispositions; 5. Energy; 6. Weaknesses and Strengths; 7. Manoeuvre; 8. The Nine Variables; 9. Marches; 10. Terrain; 11. The Nine Varieties of Ground; 12. Attack by Fire; 13. Employment of Secret Agents (Sun Tzu, 1963, translated by Griffith, S.B.).

⁸ "Stratos" is the Greek word for "army" and "ágein" means "to lead" (Duden Band 7, 1963; Grant, 2002, p. 16).

⁹ Among these Greek writers were Alexander the Great (356-323 B.C.), Polybios (philosopher and historian, 210-125 B.C) and Onasander (author of "strategos", ca. 50 A.D) (Goldschmidt, 1960).

The distinction between indirect and direct strategies has become a widespread one. However, the sinologist Harro von Senger objects to the use of these terms (Senger, 2002, pp. 46-51). Senger points out that in the original Chinese text Sun Tzu used the words “zheng” and “qi” which are central even in today’s military language of the Chinese army. According to Senger, it is more appropriate to translate “qi” with “extraordinary”, “exceptional” or “unorthodox” rather than “indirect”. Accordingly, he suggests that “ordinary”, “normal” or “orthodox” capture the meaning of “zheng” better than “direct” (Senger, 2002, pp. 46-51).

Highlighting unorthodox approaches as the more promising strategies also seems consistent with the views put forward by representatives of the positioning school of modern management science. As outlined in the next section, for instance, Porter (1996) emphasises the importance of “uniqueness” for a successful strategy and Henderson (1989) derives an approach from ecology which considers that survival is only possible in a niche. In both cases, these modern management strategists call for an unprecedented, unorthodox approach that requires imagination and creativity. Insofar, a link can clearly be made between Sun Tzu’s ancient ideas and contemporary strategic management.

During the Medieval period, the study of strategy stagnated in Europe and it only received a new impetus towards the end of the Medieval period following the decline of Byzantine Empire which led to the spread of ancient Greek writings. At the beginning of the Renaissance the strategic concepts of Greek philosophers and political leaders again came to the forefront. Among the best-known strategic thinkers of the time was Niccolo Machiavelli (1469-1527), whose writings feature remarkable parallels to Sun Tzu’s “Art of War” (Stahel, 2003, p. 71). Machiavelli pays great tribute to indirect strategies and recognises that without preparation for war there would not be lasting peace (Stahel, 2003, p. 71).

At the start of the Renaissance period, innovations and rapid technological developments revolutionised military equipment and gradually started to influence Western military strategists. Stahel concludes that most indirect

¹⁰ Professor Stahel teaches at the Swiss military academy, MILAK, where various Swiss bankers received their training. Dr Josef Ackermann, who joined Deutsche Bank in 1996, after 19 years at Credit Suisse, and

strategic considerations lost prominence when Frederick the Great's reign came to an end (Stahel, 2003, p. 93). The focus of military strategists shifted to the use of armed forces for the total destruction of the enemy through massed concentration of force.¹¹ The British military strategist and journalist Basil Henry Liddell Hart (1895-1970) holds Clausewitz partly responsible for this development by expounding a theory too abstract for concrete-minded soldiers. Yet, according to Liddell Hart, Clausewitz's disciples hold a greater share of the responsibility for the ill-effects of Clausewitz's wildly misinterpreted oeuvre "On War" (Liddell Hart's foreword in Sun Tzu, 1963, pp. V-VII).

Clausewitz defines strategy as a knowledge of the use of military engagements for the object of war, whereas tactics comprise a knowledge of the use of armed forces in combat (Clausewitz, 1997, book II, chapter I, p. 75). "Strategy is the employment of the battle to gain the end of the war; it must therefore give an aim to the whole military action, which must be in accordance with the object of the war; in other words, strategy forms the plan of the war; and to this end it links together the series of acts which are to lead to the final decision, that is to say, it makes the plans for the separate campaigns and regulates the combats to be fought in each" (Clausewitz, 1997, book III, chapter I, p. 141).

Clausewitz understood war as an extreme, albeit natural, extension of political policy and diplomacy, which led to his famous dictum: "[...] war is not merely a political act, but also a real political instrument, a continuation of political commerce, a carrying out of the same by other means" (Clausewitz, 1997, book I, chapter I, 24, p. 22). Clausewitz dismisses the parallel between war and art and points out that it could be more accurately compared to commerce, which he also sees as a conflict of human interests and activities (Clausewitz, 1997, book III, chapter I, 4, p. 148).

It is noteworthy that in fact Clausewitz understands strategy as a process, whereby the strategist cannot be detached from the implementation of strategy. As is shown in the following section, in this respect Mintzberg's writings on management strategy demonstrate remarkable parallels to

was appointed Deutsche Bank's CEO in 2002 is also a Swiss army officer.

Clausewitz's ideas. For example, Clausewitz remarks that the difficulty with strategic planning is the involvement of "things which to a great extent can only be determined on conjectures some of which turn out incorrect, while a number of other arrangements pertaining to details cannot be made at all beforehand, it follows, as a matter of course, that strategy must go with the army to the field in order to arrange particulars on the spot, and to make the modifications in the general plan which incessantly become necessary in war. Strategy can therefore never take its hand from the work for a moment" (Clausewitz, 1997, book III, chapter I, p. 142).

While Clausewitz is largely understood, rightly or wrongly, as having paved the way for direct and confrontational strategies, the Swiss military strategist Antoine-Henri Jomini (1779-1869) is regarded as having promoted the cause of indirect approaches in the tradition of Sun Tzu (Stahel, 2003, p. 170). Prior to joining the French army in 1798 to serve Napoleon, Jomini worked as a banker in Basle and Paris. In 1813, he defected from Napoleon's army and was subsequently employed on occasional basis by the Russian Tsars as a military consultant (Stahel, 2003, pp. 127-171).

According to Stahel, Jomini recognised the benefits of "the indirect approach of the direct strategy" as it had been formulated by Sun Tzu.¹² The indirect approach of the direct strategy first aims at weakening and misleading the enemy through subversion, deceit and sabotage. If these initial measures do not suffice to cause the enemy's collapse, the second step should be a direct attack by a concentrated and superior force on the enemy's weakest flank (Stahel, 2003, pp. 29-32, p. 168).

Jomini distinguishes between strategy, grand tactics ("la grande tactique"), logistics, engineering and detailed tactics. For him strategy is a top-down approach, in contrast to tactics that follow a bottom-up approach. Jomini also recognises that a precise demarcation of strategy, high tactics and logistics is nearly impossible and that they are closely interrelated (Stahel, 2003, pp. 159-160). According to Stahel, Jomini wrote a strategic handbook whereas

¹¹ This development culminated in Erich Ludendorff's (1865-1937) concept of "total war", whereby all areas of the state and society are harnessed for the purposes of war.

¹² Given the absence of any major wars in Switzerland for the past several hundred years – with the exception of Napoleon's short intermezzo – this small country in the heart of Europe could focus on its commercial strengths, while maintaining political neutrality in international affairs. Thus, Switzerland's military strategy and foreign policy may be considered to have been highly successful.

Clausewitz's writings essentially comprise hypotheses about the origins and causes of wars. In Stahel's view it is deplorable that German generals of the 19th century and most Western military leaders of the 20th century derived their strategies from Clausewitz's "war philosophy" and not from Jomini's considerations about the "indirect approach" (Stahel, 2003, pp. 170).

Liddell Hart goes even further in his criticism of Clausewitz by contrasting his ideas with those of Sun Tzu: "Civilization might have been spared much of the damage suffered in the world wars of this century if the influence of Clausewitz's monumental tomes *On War*, which moulded European military thought in the era preceding the First World War, had been blended with and balanced by a knowledge of Sun Tzu's exposition on the *Art of War*" (Liddell Hart's foreword in Sun Tzu, 1963, p. V). During the early 20th century, it was primarily Liddell Hart who recognised the power of indirect strategies and therefore built on Sun Tzu's original ideas.

Throughout history, from Sun Tzu to modern management strategists, four key factors appear to contribute to a successful strategy (Grant, 2002, pp. 11-13). First, there should be a long-term, simple and consistent objective. Second, a profound understanding of the competitive environment appears an essential ingredient. Third, the availability of resources should be appraised as objectively as possible. Fourth, effective implementation is the final hurdle for the strategy to become successful (Sun Tzu, 1963; Grant, 2002, pp. 11-13).

As the implementation of most strategies can be broken down into incremental decisions (Lindblom, 1959; Quinn, 1980), it may be argued that at some point strategy implementation turns into a mere opportunistic, adaptive muddling-through process, possibly described as tactics. As noted by Jomini, tactics is a bottom-up approach to strategy implementation, thus tactics and strategy are interdependent developments which need to be orchestrated by the strategist, who is aware of the overarching thrust and the interaction of strategy and tactics. If, however, a strategy leads to unsuccessful tactics, then the overall strategy needs to be questioned and reviewed, as no war can be won, if all battles are lost.

One risk emerges when a strategy, which should provide orientation, is frequently and fundamentally changed so that it gradually degenerates into a

mere chain of tactics, lacking any coherence. Equally dangerous is the assumption that a sequence of successful tactics represents a strategy. Senger points out that tactics need to be analysed in their strategic context, as minor events can eventually have overwhelmingly large strategic consequences. Despite his warning that tactics can backfire at the overall strategy, Senger concludes that not too much attention should be paid to the differences between strategies and tactics, although these terms should not be used interchangeably (Senger, 2002, pp. 20-24).

In addition to enhancing understanding of strategy vis-à-vis tactics, the proximity between military/political and corporate strategies needs to be considered in the context of this historical review. The link between military/political and corporate strategies is of particular importance for politically sensitive industries such as the banking sector. Moreover, an analysis of the competitive advantages of different countries demonstrates various similarities to a corporate analysis, as put forward by Porter (1990).

In this respect, the example of Switzerland is worth highlighting. Despite having few natural resources, no colonial past and no seacoast, Switzerland has become one of the world's richest countries, owing most of this success to its political and military stability. It may be assumed that this stable military/political and economic environment has contributed to the emergence of Switzerland as a leading global financial centre, home to two of the world's largest banks (UBS and Credit Suisse Group), the world's largest reinsurance company (Swiss Re) and various other financial institutions.

The case of Switzerland illustrates the relationship between sustainable military and political stability on one hand, and a country's prosperity on the other. Indirect strategies, i.e. unorthodox strategies which offer a unique solution, avoid immediate confrontation as they focus on "positions" which have not yet been taken by competitors. So, for example, until recently Switzerland could claim to be more or less the only significant "off-shore" banking centre in the world. Thus, such indirect approaches seem to enhance the stability of an organisation or a country. A stable organisation is understood as one with low strategic and operational volatility. Low operational volatility implies that the system's input and output factors do not

fluctuate to a great extent and that the system maintains its key functions even under exogenous shocks.

Stability is a key factor for operational progress and an organisation's profitability can be enhanced by managing volatility. Thus, managing volatility should constitute a primary strategic task. Strategic management therefore becomes the managing of risks. As risk emerges in dealing with external conditions, a company needs to be analysed in its environment. Thus, risk analysis and strategy analysis deal with complexity by concentrating on the essential structural factors which determine the sensitivities of the system. Studying the organisation in its environment over a substantial period becomes a principal necessity for managing risk, thus managing volatility and ultimately for managing an organisation. This leads to the discussion of the various understandings of "strategy" in contemporary business studies and how that term is used throughout this thesis.

3.3. A multifaceted term: “strategy” as it is used in this research

The term “strategy” enjoys great popularity among managers, politicians and policy-makers. According to conventional management textbooks, strategic reasoning is aimed at guiding the decision-making process, whereby strategy itself represents an overall “plan for deploying resources to establish a favourable position” (Grant, 2002, pp. 16-17).

Quinn defines management strategy as “the pattern or plan that integrates an organisation’s major goals, policies and action sequences into a cohesive whole. A well-formulated strategy helps marshal and allocates an organization’s resources into a unique and viable posture based upon its relative internal competencies and shortcomings, anticipated in the environment, and contingent moves by intelligent opponents” (Quinn, 1980, p. 7).

Research about management strategies comprises a wide range of organisational studies (Starbuck, 1965, p. 468; Mintzberg et al., 1998, pp. 7-9), most of which address the underlying questions about the different sources of a company’s profitability.¹³ Various attempts have been made to categorise the different approaches to the study of organisations (Grant, 2002; Mintzberg et al., 1998; Whittington, 1993) and to clarify the somehow inflationary use of the term “strategy”.

Whittington identifies four different schools: the Classic school¹⁴ which sees strategy as a formally planned approach aimed at profit maximization; the Processual school¹⁵ is described by him as inward-looking which recognises the importance of internal political bargaining processes and the development of skills and core competences; the Evolutionary school¹⁶ understands strategy as a means to survival in a hostile environment, with markets

¹³ For the purpose of this research it is assumed that a company intends to create value and to enhance its profitability.

¹⁴ Key authors: Chandler, Ansoff, Porter (Whittington, 1993, pp. 10-41).

¹⁵ Key authors: Cyert & March, Mintzberg, Pettigrew (Whittington, 1993, pp. 10-41).

¹⁶ Key authors: Hannan & Freeman, Williamson (Whittington, 1993, pp. 10-41).

determining the natural selection process; the Systemic concept¹⁷ emphasises the social context of strategy-making (Whittington, 1993, pp. 10-41).

Mintzberg distinguishes between five different understandings of strategy. The implicitly different usages of the term strategy should, according to Mintzberg, be explicitly recognised and strategy can be categorised as plan, pattern, perspective, position, and ploy (Mintzberg, 1987b; 1998). The following discussion builds on Mintzberg's five categories.

¹⁷ Key authors: Granovetter, Marris (Whittington, 1993, pp. 10-41).

3.3.1. Strategy as plan

The most common and ad-hoc definition of strategy would interpret strategy as a plan, i.e. as “some sort of consciously intended course of action, a guideline [...] to deal with a situation” (Mintzberg, 1987b, p. 11). Such an understanding views strategy as a direction or a “path to get from here to there” (Mintzberg et al., 1998, p. 9). In the same vein, Drucker talks about strategy as “purposeful action” (Drucker, 1974, p. 104), while the fathers of modern game theory make it clear that strategy is “a complete plan: a plan which specifies what choices [the player] will make in every possible situation” (Morgenstern & Newmann, 1944, p. 79).

Moore points out one difficulty with the view of strategy as a plan when he remarks that such an understanding is far too static as strategies serve the purpose of achieving certain ends among people (Moore quoted in Mintzberg, 1987b, p. 21). Moore’s objection assumes a linear concept of a plan, whereby a plan describes a detailed path that leads from point A directly to point B. In contrast, planning can also comprise scenario analysis, which enables the strategic planner to “predict and prepare” (Ackoff, 1983, p. 59).

Ackoff notes that “the more accurately we can predict, the less effectively we can prepare; and the more effectively we can prepare, the less we need to predict” (Ackoff, 1983, p. 60). Thus, the paradigm of “predict and prepare” suffers from interdeterminacy in an indeterministic world. As a way out of this dilemma, Ackoff suggests controlling the causes and effects, which determine the working of the system thereby reducing the exposure to the risk of the unexpected (Ackoff, 1983).

Mintzberg goes even further by arguing that strategic planning may actually impede strategic thinking (Mintzberg, 1994). He dismisses the assumption that strategists can be detached from their strategies and that strategy making can be formalised – a view that can already be found in Clausewitz’ writings (Clausewitz, 1997, book III, chapter I, p. 142). According to Mintzberg, strategic planning should merely supply the formal analyses that strategic thinking requires (Mintzberg, 1994). Thus, Mintzberg still acknowledges the significance of planning as part of the all-encompassing strategy process (Mintzberg et al., 1998). He views strategic planning essentially as analytical,

based on decomposition, while strategy creation is a process of synthesis (Mintzberg, 1987a).

Although this research dismisses any deterministic understanding of history, it recognises that existing structures condition the actions of humans. Individuals, groups and organisations develop structures with varying interdependences over time. However, these structures do not simply constrain humans; they also enable them to act and interact (Giddens, 1976, 1984, 1988).¹⁸ On the basis of these discerned patterns and interdependences it is possible to derive some guidance for the formulation of forward-looking decision-making processes. In fact, building on the experience of certain patterns and structures is a prerequisite for any learning process and lies at the heart of any socio-economic progress.

While this research acknowledges that such tentative structures facilitate the decision-making process, it also emphasises the preliminary status of these premises, which ultimately cannot be verified. This reasoning is based on Popper's critical rationalism, which holds that a hypothesis cannot be verified but only tested until it is ultimately proven to be wrong ("falsified") and subsequently replaced by a modified hypothesis (Popper, 1979, 1989). In the context of strategic management, the understanding of planning is therefore not entirely dismissed, but the conceptual pitfalls are taken into account. The understanding of strategy as an intended plan of action is forward-looking, whereas the understanding of strategy as a pattern focuses on realised past behaviour (Mintzberg et al., 1998, p. 9).

¹⁸ Giddens' structuration theory is further elaborated in chapter four on methodology.

3.3.2. Strategy as pattern and structure

Patterns are the result of consistency of behaviour over time (Mintzberg et al., 1998, p. 9). Mintzberg offers a definition of strategy as pattern, whereby strategy "is consistency in behaviour, whether or not intended" (Mintzberg, 1987b, p. 12). According to Mintzberg, there is a difference between intended and realised strategies, which raises the pressing question as to how strategies emerge.

Identifying the difference between intended and realised strategies, Mintzberg actually also pays tribute to strategy formulation: "Purely deliberate strategy precludes learning once the strategy is formulated; emergent strategy fosters it. [...] In practice, of course, all strategy making walks on two feet, one deliberate, the other emergent. For just as purely deliberate strategy making precludes learning, so purely emergent strategy making precludes control. Pushed to the limit, neither approach makes much sense. Learning must be coupled with control" (Mintzberg, 1987a, p. 70).

Behaviour is an incremental evolutionary process, which constantly adapts to a changing environment. Unless a specific behaviour can be measured against an intended strategy (that is an announced behaviour), behaviour itself is always consistent. It can only become inconsistent if contrasted with a preceding statement or a declaration of intent that differs from actual behaviour.¹⁹ However, even then, the external observer cannot know if these statements were not deliberately false, making them appear inconsistent only from the observer's point of view, and not from the strategist's perspective. Therefore, it can be argued that without a benchmark, only statements, but not behaviour itself, can be inconsistent.²⁰ This pinpoints the dilemma that, with hindsight, all successful behaviour becomes strategic.²¹

¹⁹ The term "consistent" stems from the Latin word "consistere" which originally meant "to stand still".

²⁰ The benchmark for statements is a common language with clear meanings attached to each word. A statement like: "water is dry", is only perceived as inconsistent because there is a clear meaning attached to each word which describes different and mutually exclusive conditions.

²¹ This research recognises the risk of tautological concepts in strategic management that, just like Freudian psychoanalysis, always offer an explanation for everything within the field of human behaviour. This reasoning draws on Karl R. Popper's "problem of demarcation", which he introduces in his book "Conjectures and Refutations". Popper dismisses the "theories" by Alfred Adler, Sigmund Freud and Karl Marx as scientific, since their ideas "appeared to be able to explain practically everything that happened within the fields to which they referred" (Popper, 1989, pp. 33-39).

3.3.3. Strategy as perspective

Strategy as perspective is an inward-looking concept, representing a certain perception of the world according to Mintzberg (Mintzberg, 1987, p. 16). Therefore, this understanding of strategy is holistic, whereby strategy “is to the organization what personality is to the individual” (Mintzberg, 1987, p. 16). Thus, strategy as perspective is often referred to as “corporate culture”. For example, a “culture of success” is ascribed to the US investment bank Goldman Sachs (Endlich, 1999), whereas the small German merchant bank Metzler regards its independent, entrepreneurial spirit with a human touch as the key values that determine its culture.²²

Strategy as perspective emphasises the abstract nature of strategies, which essentially seem to exist in the minds of the interested parties (Mintzberg, 1987, p. 16). Mintzberg rightly notes that strategy as perspective can unfold its psychological power once the members of an organisation share this perspective and a collective mind emerges. As strategies are not tangible, these are effectively concepts which convey certain ideas, values, and possibly even ideologies.²³

Campbell and Yeung distinguish between “mission” as a strategic tool, which defines the commercial rationale of a company, and “mission” as the cultural glue which facilitates the working of the organisation as a collective entity (Campbell & Yeung, 1990, 1991). Mission as a cultural glue aims at creating a common mindset through shared values and standards of behaviour, but it also attempts to capture emotional aspects which may influence the work atmosphere (Campbell & Yeung, 1990, 1991).

Research which comprehends strategy as perspective would, for example, analyse how to read the “collective mind” (Mintzberg, 1987, p. 17) and how messages and stated intentions are diffused throughout the organisation and how actions are subsequently implemented with the necessary degree of consistency. Eccles and Nohria (Eccles & Nohria, 1992) put language at the

²² Available from: <http://www.metzler.com> [Accessed 23 June 2004].

²³ Anecdotal evidence is provided by Ahmass Fakahany, Merrill Lynch’s Chief Financial Officer. He sees the reasons for the bank’s relative underperformance during the 1990s in a “tolerance of mediocrity” and a “family culture”. Ultimately, this was replaced by a “performance culture”, which then paved the way for success (FT, 2 July 2004).

forefront of their analysis of management, as language and rhetoric are powerful forces within organisations. For them, strategy should be best analysed through the prism of rhetoric, action, and identity, as this allows a manager to design strategy most effectively (Eccles & Nohria, 1992).

An understanding of strategy as perspective opens up important aspects of research, not least as the morale of a company's employees contributes to the quality and efficiency of work done in an organisation. It is a frequently used argument against creating multi-business companies that the different cultures are difficult to reconcile (Grant, 1992, pp. 226-227). Even within the relatively homogenous financial services sector one observation is that, for example, the mindsets of an investment banker and a retail banker, both working for the same institution, differ so much from each other that their communication might be impeded.²⁴

Although strategy as perspective offers valuable contributions for the study of strategic management, this understanding is too inward-oriented for the purpose of this research, which aims at understanding the interdependence of micro- and macrostructure in the banking industry. Yet, it is worth highlighting that, for instance, an in-depth case study about the different work ethos at British and German banks or about the changing values of investment bankers throughout the 1990s would constitute highly useful and complementary research projects.²⁵

²⁴ The international environment in which investment bankers work makes them more likely to use English terms in their everyday language than may be the case with retail bankers whose environment is usually local.

²⁵ For example, Baethge, Kitay and Regini studied the changing nature of employment relations in retail banking in nine countries, among them the UK and Germany (Baethge, Kitay & Regini (eds.), 1999).

3.3.4. Strategic positioning

In addition to the distinction between strategy as plan, pattern and perspective, Mintzberg recognises that strategy is about positioning. Strategy as position refers to an understanding of strategy as a “means of locating an organization in what organization theorists like to call an “environment.” By this definition, strategy becomes the mediating force [...] between organization and environment, that is, between the internal and the external context” (Mintzberg, 1987, p. 15). Mintzberg also notes that this definition of strategy can be compatible with the definition of strategy as plan.

Understanding strategy as position is at the heart of Porter’s analysis of companies’ competitive advantage (Porter, 1979, 1980, 1985, 1998). Therefore Porter first clarifies the notion of “positioning” prior to answering the question in his essay “What is Strategy?” (Porter, 1996). According to Porter, positioning can be either based on producing a subset of an industry’s products or services or by serving the needs of a particular group of customers. Alternatively positioning can be achieved by segmenting customers who can be reached in different ways (Porter, 1996). Whether these three approaches are applied separately or combined with each other, positioning is a function of differences on the supply side, thus differences in activities, according to Porter (Porter, 1996).

Porter argues, “strategy is the creation of a unique and valuable position, involving a different set of activities” (Porter, 1996, p. 68). He remarks that a sustainable strategic position requires trade-offs, i.e. activities which are incompatible. Thus he notes that the “essence of strategy is choosing what not to do” (Porter, 1996, p. 70). The final aspect of strategy put forward by Porter is that positioning also determines how the individual activities of a company represent an array of interlocked activities. Porter understands competitive strategy as being different and as “deliberately choosing a different set of activities to deliver a unique mix of value” (Porter, 1996, p. 64). Therefore, he emphasises that operational effectiveness, albeit a necessary condition for achieving superior profitability, should not be confused with strategy, as it usually lacks sustainability.²⁶

²⁶ Porter explains that strategic positions should have a horizon of a decade or more, not of a single planning cycle. He suggests that this leads to continuity which “fosters improvements in individual activities

The view that strategy is in essence about positioning as, for example, propagated by Porter complements the understanding of strategy as plan insofar as it focuses more on the content of strategies. For this reason, Porter is believed to have added substance to the planning school (Mintzberg et al., 1998, pp. 82-122). Yet, Mintzberg criticises Porter for a too narrow understanding of the term strategy which largely focuses on the quantifiable economic aspects – Mintzberg tries to corroborate his criticism by pointing out that neither the word “political” nor “politics” appears in the table of contents, or the index of Porter’s main book “Competitive Strategy” (Mintzberg et al., 1998, p. 113).

Porter’s understanding of strategy does not seem to sufficiently recognise the potential influence of political factors. Porter’s neoclassical understanding of economics limits its applicability in such a highly politicised industry environment as the banking sector in general and the German banking sector in particular. The limitations of Porter’s model for analysing the banking sector are discussed in section five of this chapter.

Despite these limitations, an understanding of strategy as position facilitates the analysis of firms within their industry. The positioning school maintains that industry structure conditions corporate strategy and thus also shapes corporate structure. Consequently, Porter’s writings stand in the tradition of Chandler’s dictum that “structure follows strategy” (Chandler, 1962). Chandler defines strategy as “the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out those goals” (Chandler, 1962, p. 13).

This view has been challenged by researchers who focus on the organisation’s capacity (Hamel & Prahalad, 1989, 1990). By arguing that a company’s resources and capabilities ultimately determine the feasibility of the strategy considered, this view suggests that “strategy follows structure”. As this research concentrates on realised corporate strategies in a changing macroeconomic environment, the discussion as to whether strategy follows

and the fit across activities, allowing an organisation to build unique capabilities and skills tailored to its strategy. Continuity also reinforces a company’s identity” (Porter, 1996, p. 74).

structure, or the other way around, or whether, as advanced by Peters, strategy is structure (Grant, 2002, p. 189) is elaborated in chapter four in the context of the methodology used in this research.

Understanding strategy as position implies another weakness: "position" is always defined by two coordinates on a map, or by three coordinates in space. Therefore obtaining a clear position entails a relatively static understanding of strategy. Moreover occupying a clearly defined position also opens it up to precise attack. As noted by Mintzberg, "Porter's basic model indicates what writers of military strategy call a 'come as you are' approach to strategy" (Mintzberg et al., 1998, p. 120), whereby you can only change your position before or after the confrontation. For a strategic process to be successful, what is important is the organisation's ability to learn and to swiftly move from one place to another, without disclosing the new direction it is intending to take.

Strategy as positioning, particularly in a niche, is also the understanding of Henderson, founder of the Boston Consulting Group, a management consultancy company. Henderson derives his view of strategy as position from Gause's "Principle of Competitive Exclusion", whereby "no two species can coexist that make their living in the identical way" (Henderson, 1989, p. 139). Henderson argues that competitors must be sufficiently different to sustain their advantages, which have to be mutually exclusive. However, unlike Porter's understanding, Henderson offers a narrower interpretation of strategy, which he essentially regards as "a deliberate search for a plan of action that will develop a business's competitive advantage and compound it" (Henderson, 1989, p. 139).

3.3.5. Strategy as ploy and tactic

Strategy as ploy is Mintzberg's fifth understanding of strategy. He considers a ploy to be "a specific manoeuvre intended to outwit an opponent or competitor" (Mintzberg, 1987, p. 12). His use of ploy refers to tactics and stratagems as part of the strategy process. Grant argues that a tactic is more of a singular action, which is relatively independent of time, leading to immediate results, whereas strategy unfolds over time and indicates a clear thrust. Therefore, he considers tactics as subordinated to the strategic concept. A tactic or a stratagem comprises methods for specific actions which should be consistent with the overarching strategy (Grant, 2002, p. 17).

Tactics and stratagems serve an immediate objective and, unlike strategies, are more easily reversible as they involve fewer resources. As discussed in the section about strategy in its historical context, tactics hold a particularly prominent position within the tradition of military strategic thinking. Grant succinctly describes tactics as measures to win battles, while strategies are aimed at winning the war (Grant, 2002, p. 17).

Game theorists Brandenburger and Nalebuff describe tactics as moves that shape the way players perceive the game and hence how they play. Therefore, some tactics reduce misperceptions and others are designed to create or maintain uncertainty (Brandenburger & Nalebuff, 1995, 1996; Dixit & Nalebuff, 1991). One aspect of tactics can take the form of the signals a company sends to the market. "The term signaling is used to describe the selective communication of information to competitors designed to influence their perception and hence to provoke or avoid certain types of reaction" (Grant, 2002, p. 110).

Porter emphasises the importance of analysing firms' signals for developing competitive strategies (Porter, 1998, pp. 75-87). He suggests that market participants can use "signals" to directly or indirectly indicate intentions, motives, goals, or internal situations (Porter, 1998, p. 75). Porter distinguishes between market signals, which are earnest indications, and other which are bluffs aimed at misleading competing firms. In either case, signals need to be credible to be effective (Camerer & Weigelt, 1988; Heil & Robertson, 1991).

This section on the different understandings of strategy concludes by emphasising the multifaceted nature of the term “strategy”. The author of this thesis subscribes to Mintzberg’s understanding that “strategy” is in fact a “strategy process” which comprises planning, positioning, and the use of ploy and perspective, which in retrospect may feature some pattern.

3.3.6. Between micro and macrostructure: “strategy” in this research

Recognising the complexity of the strategy process and acknowledging the different methods used to study the strategy process does not imply that a research project about strategic management has to comprise all of these approaches. On the contrary, it appears perfectly appropriate to focus on just one aspect of this strategy process, as long as this does not deny the significance of all the other coexisting concepts and methods. This research emphasises the understanding of strategy as pattern, which results from changing corporate strategic positions over a substantial length of time.

Yet, there is still the need to clarify the level on which the strategy analysis used in this research is carried out; that is to ask: The “positioning” of what? Strategic management literature distinguishes between corporate strategy and business strategy (Grant, 2002).²⁷ Corporate strategy is concerned with the scope of a firm in terms of industries, markets, diversification, allocation of equity and corporate resources, etc. whereas business strategy deals with establishing a competitive advantage for a defined product/client matrix.²⁸ Consistent with the aforementioned view that strategy is a process, it cannot be upheld that there is a clear distinction between corporate and business strategy.²⁹

Corporate strategy is the efficient and stable use of a firm’s limited resources and capabilities in order to add value, whilst yielding a profit that adequately accounts for the operational risks. Consequently, corporate strategy is the interface between a firm’s resources and capabilities and its environment (Grant, 2002, p. 132). A successful corporate strategy is the outcome of successfully implemented business strategies, which can be realised by drawing on a set of benign corporate and environmental conditions.

²⁷ Obviously, a review of the literature about business strategies in banking can swiftly drift into any operational banking literature which uses the term “strategy” as a buzzword. For example, books like “Alternative Risk Strategies” by Lane (2002) or “Bond Markets: analysis and strategies” by Fabozzi (2000) are clearly geared to the operational level and have little to do with corporate strategy.

²⁸ A product/client matrix defines the range of products and services offered to certain client groups (e.g. housing mortgages for UK clients).

²⁹ “Corporate strategy” refers to decisions on group level (i.e. at the level of the holding company).

Corporate strategy is concerned with decisions that involve the allocation of resources and capital to such an extent that it implies a structural shift for the organisation, which cannot be easily reversed - put simply, corporate strategy refers to decisions which have to be approved by the board of directors. Since corporate strategies can imply substantial structural, financial and legal consequences, the owner of the firm ought to be informed. Thus, the management of publicly listed companies has to inform shareholders about the firm's corporate strategy.³⁰

In order to illustrate the difference between corporate and business strategies in the context of banking, consider the following example: The decision to scale back the bank's risk-weighted assets (RWA)³¹ can be described as corporate strategy since it profoundly alters the bank's risk profile and earnings structure, whereas the specific measures for reducing the risk-weighted assets, e.g. through securitisation, tightening of credit policy, setting up of special purpose vehicle, etc., is subject to the bank's business strategies.

So far, this third chapter has elaborated the term strategy and the conceptual roots of strategy in the military/political tradition, complementing the review in chapter two of the importance of banks as part of the financial system. Subsequently, this research discusses strategic management theories. At the heart of the remaining sections of this chapter, Porter's strategic management theory (the five forces framework) is analysed in the context of the banking industry. Porter's framework for competition analysis is contrasted with Hamel and Prahalad's theory about a company's core competence and reviewed critically in the light of Brandenburger and Nalebuff's use of game theory for competition analysis and strategic management.

³⁰ A change of corporate strategy may contain information that could influence the share price and which must therefore be disclosed as an ad-hoc statement in order to comply with the regulations for securities trading.

³¹ Risk-weighted assets are assets shown on a balance sheet of a bank which are calculated on a risk-adjusted basis as defined by the regulatory agency (Golin, 2001).

3.4. Economic structures revisited – competitive forces in the banking industry

Dealing with competition is central to strategic management. Competition exists because of the scarcity of goods and services. The level of competition is determined by demand and supply for a good or service. Economists distinguish between perfect and imperfect competition. In an economist's model of perfect competition, the number of buyers and sellers for a particular good (or service³²) is so large that none of them believes their actions have a noticeable effect on the equilibrium price (Stiglitz, 1993, p. 395).

In a market where competition is "imperfect", the individual firm assumes that its sales depend on the price it charges and other measures, such as marketing (Stiglitz, 1993, p. 397). Imperfect competition can take the extreme form of a monopoly whereby there is effectively only one supplier of a good or service in the industry (Varian, 1990, p. 396). The price charged by a monopolist is a function of the demand curve for the good (service) and the threat of losing its monopoly. If the monopolist's profit margin seems attractively high, providers of capital would attempt to enter the same market, breaking the monopoly. Moreover, monopolists face possible sanctions from regulatory authorities, mainly spurred by consumer protection groups.

A less extreme form of imperfect competition can be found in an oligopolistic market structure, where there a number of competitors in the market, whose pricing policy has an impact on the market price and consequently on the sales of the other firms in the market. Thus, there exists a strategic interdependence between such firms (Varian, 1990, pp. 439-460).

Grant notes that "business is about the creation of value for the customer" (Grant, 2002, p. 67). Value can either be created through production, i.e. the transformation of inputs into outputs or through arbitrage, that is, the transfer of products across time and space (Grant, 2002, p. 67). It is accepted for this research that corporate strategies are aimed at increasing or at least

³² Throughout this research, the terms "product", "goods" and "services" are used interchangeably, unless a more specific definition is necessary. All three terms refer to the output of a company or industry. Although it is not always easy to clearly distinguish between "production" and "sales" in the financial services sector, such a distinction facilitates an understanding of the workings of a financial services organisation and is widely accepted by managers in the financial services industry.

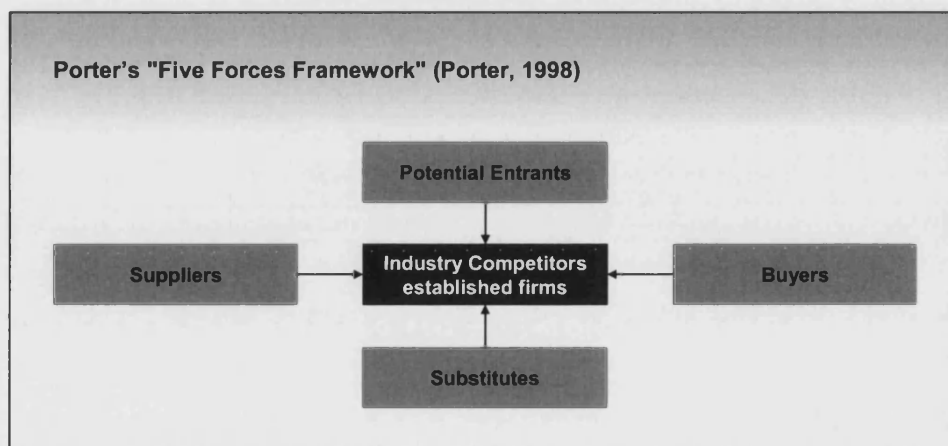
maintaining the company's profitability (Grant, 2002, p. 67). Profitability is defined as the return for the owner of the company, i.e. the return on equity (ROE). A firm's profitability is determined by the split of value creation between consumer and producer. Conventional microeconomic theory propounds that the distribution between consumer surplus and producer surplus is a result of the level of competition, i.e. the number and relative bargaining power of buyers and sellers (Grant, 2002, p. 68).

Consumer surplus is defined as the difference between what the buyer would be willing to pay for a good/service and what he/she actually has to pay. Thus, the consumer surplus is a function of the consumer's utility derived from the product or service and the price charged for it. Producer surplus is the difference between the price charged by the seller for a product/service and the minimum price for which the firm would be willing to sell, usually the average cost (Varian, 1990, pp. 240-255; Katz & Rosen, 1994, p. 141).

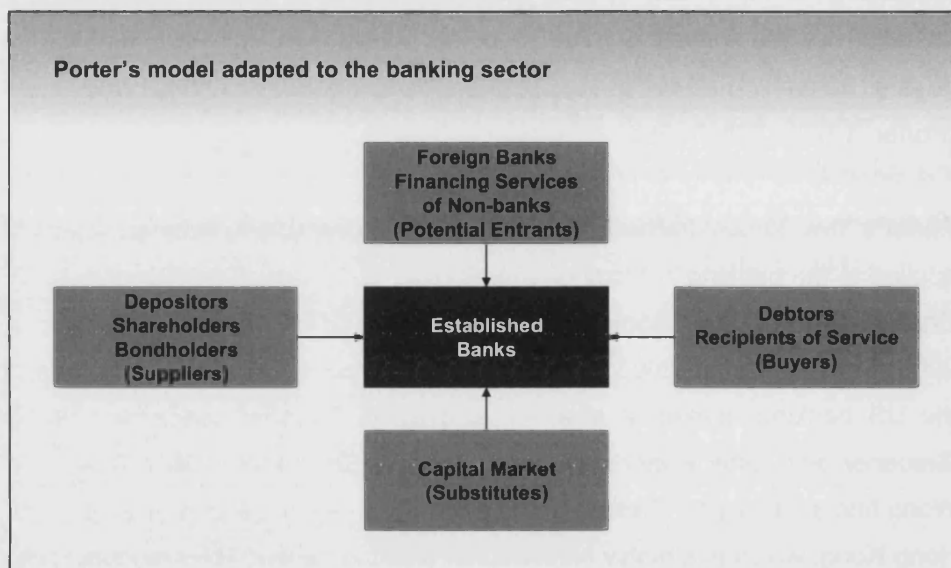
3.4.1. A framework for competition analysis

The amount and distribution of the value created, i.e. the consumer and producer surplus, is determined by the underlying economic structure of the industry (Porter, 1979, 1980, 1998). Porter argues that an analysis of these underlying structural features is essential to understand the competitive forces in the relevant industry (Porter, 1998, p. 3). Subsequently, he suggests that the nature and degree of an industry's competition, thus an industry's profitability, is influenced by five competing currents. These five forces are identified as the threats of new entrants, substitution, bargaining power of buyers, bargaining power of suppliers and rivalry among existing competitors (Porter, 1979, 1980, 1998).

Porter's five forces framework is the most widely used strategic concept applied to the banking industry (Ballarin, 1986; Gardener, 1990; Canals, 1993; Chan & Wong, 1999; Börner, 2000; Hackethal, 2001; Büschgen & Börner, 2003; Smith & Walter, 2003). Ballarin applies Porter's model to an analysis of the US banking market. A strategy analysis of financial conglomerates by Gardener also uses Porter's five forces model (Gardener, 1990). Chan and Wong find evidence for Porter's theory through an empirical cluster analysis of Hong Kong, which is a highly international banking centre. Their research also shows that well-resourced banks with a multi-strategic approach outperform "strategically monotonous" rivals, thus corroborating the resource-based view (Chan & Wong, 1999). Börner develops an integrated concept that combines the positioning school with the resource-based view (Börner, 2000).



Canals uses Porter's five forces model for his analysis of the changing structure of European banking at the beginning of the 1990s (Canals, 1993, pp. 185-196). He concludes that increased competition results from deregulation, globalisation and the sector's attractiveness (Canals, 1993, p. 195). Canals holds that deregulation, along with financial disintermediation, "have considerably diminished the competitive position of banks [...]" (Canals, 1993, p. 196) and changed the structure of the banking system to such an extent that banks need to adjust their strategies.



In order to better comprehend Porter's model, it should be recalled that in economic theory an industry that generates a return above its risk-adjusted cost of capital attracts new entrants. These new entrants can be firms which are active in similar or other industries, or mere financial investors seeking attractive yields. In a perfectly efficient market economy, excess returns are unlikely to be upheld for long. Rates of return that exceed the cost of capital attract funds into this industry, thus increasing competition. As a result, competition drives down profit margins and the return on capital declines to the cost of capital. Similarly, competitors exit an industry if the return on capital falls below the cost of capital. Yet, perfect markets exist only in imperfect economic textbooks and reality is perfectly complex. Therefore, barriers to entry are much more diverse and cannot be reduced to a mere financial cost of capital versus return of capital analysis.

Consequently, this research takes a critical view of models that attempt to explain the varying profitabilities of British and German banks by the difference between a shareholder value approach and a stakeholder value approach (Llewellyn, 2005). The shareholder value concept is an approach to business planning that places the maximisation of the value of shareholders' equity above other business objectives (Dictionary of Finance and Banking, 1997).

Proponents of the shareholder value approach generally regard the stakeholder value concept as the competing paradigm for managing firms. The stakeholder value concept recognises the multiple interests of a broad range of groups affected by the actions of a firm, including its owners, i.e. the shareholders (Freeman, 1983). It follows that the stakeholder concept is an extension of the narrower shareholder value concept and thus does not stand in contradiction to it.

The large number of state-owned savings banks and mutual cooperative banks in Germany nourished the argument that the German banking system is essentially a stakeholder value oriented system, whereas the UK is predominantly a shareholder value oriented system, and that this difference largely explains the different levels of profitability (Llewellyn, 2005). Llewellyn holds that "[...] British banks have been highly profitable partly because they have chosen to be profitable in that, compared with banks in some European countries, they set the ROE as the central and uncompromising business objective" (Llewellyn, 2005, p. 309).

There is certainly some truth in the fact that the more capital market-oriented British system has made the management of banks more aware of shareholders' expectations than their German counterparts. However, a model that attempts to explain higher returns on equity from management's greater adherence to the shareholder value concept does not sufficiently consider other structural components that determine competitiveness.

3.4.2. Barriers to entry in banking

Porter offers a rather differentiated picture of barriers to entry. In his definition of barriers to entry, he also includes economies of scale (Porter, 1998, pp. 7-23). Economies of scale refer to a decline in long-term average costs as output rises.³³ Thus, the unit costs of a product fall as volume per period increases (Porter, 1998, p. 7; Katz & Rosen, 1994, p. 291). High economies of scale “deter entry by forcing the entrant to come in at large scale and risk strong reaction from existing firms or come in at a small scale and accept a cost disadvantage [...]” (Porter, 1998, p. 7).

Although it is usually argued that economies of scale apply particularly to capital-intensive industries, the case of the banking industry appears somewhat ambiguous. Most studies about efficiency in banking indicate that economies of scale are hard to find at group level (Benston et al., 1982; Gilligan et al., 1984; Molyneux et al., 1996; Berger, 2000; Berger et al., 2000). These studies show that a bank’s size does not seem to have a major effect on its performance. A review of empirical studies shows that on average scale economies and diseconomies account for only 5% of the difference in unit costs between financial services firms (Smith & Walter, 2003, p. 378). On the basis of European banking data Walter concludes that “for most banks and non-bank financial firms in the euro-zone, except the very smallest among them, scale economies seem likely to have relatively little bearing on competitive performance” (Walter, 1999, p. 152).

However, scalability varies significantly between the different banking businesses, depending on the standardisation of products and distribution structures. Walter therefore remarks that it would be wrong to concentrate solely on corporate (group-level) scale economies when there is obvious potential for efficiency gains through size at the level of individual financial services, such as global custody, processing of mass-market credit card transactions and institutional asset management (Walter, 1999, p. 153; Smith & Walter, 2003, p. 379). In contrast, M&A advisory services and private banking are very service-intensive and require detailed product specification,

³³ Porter notes that if the proportion of costs for outside inputs is high, i.e. if the relative value added is low, then high fixed costs can turn into a problem if demand declines. Thus, the decisive ratio is fixed costs relative to value added rather than as a proportion of total costs (Porter, 1998, p. 18).

leading to high fixed costs and thus limited economies of scale (Walter, 1999, p. 153; Smith & Walter, 2003, p. 379). Other research findings suggest that economies of scale are particularly limited in commercial banking (Hackethal, 2001, p. 23). Overall, the limited efficiency gains for banking groups (at corporate level) and the evident scalability of certain banking businesses support Canals' critical view of universal banking and strengthens the case for specialisation in banking (Canals, 1999).

Despite these reservations about efficiency gains resulting from size at group level in the banking sector, Walter concludes: "It seems reasonable that a scale-driven pan-European strategy may make a great deal of sense in specific areas of financial activity even in the absence of evidence that there is very much to be gained at the firm-wide level" (Walter, 1999, p. 153). Schmidt estimates that the growing significance of information technology increases the minimum efficient firm size in the banking industry (Schmidt, 2001, p. 11). The rapid developments in information technology should have a bigger impact on retail banking than on any other banking business, providing a rationale for mergers and acquisitions to reduce superfluous retail capacity. According to Schmidt, consolidation should be mainly national as this allows for the greatest cost-savings, for example, by closing down bank branches (Schmidt, 2001, p. 11).

The rationale for mergers or acquisitions in banking is diverse. Among the principal motifs for M&A cited by senior bank managers are cost synergies in the form of economies of scale and scope (Dermine, 1999). Focarelli and his colleagues find that expanding revenues is the major strategic objective for mergers (Focarelli, Panetta & Salleo, 2002). Other explanations for mergers and acquisitions in the banking industry comprise gaining access to new markets and to information and proprietary technologies (Goddard, Molyneux & Wilson, 2001).

Furthermore management's ambition to increase market power and improve the group's risk profile by broadening the loan base³⁴ are also put forward as reasons (Goddard, Molyneux & Wilson, 2001). Additional arguments for M&A activities in banking (as in other industries) are hubris and management's own

personal (e.g. financial) interests to work for a larger bank (Eijffinger & de Haan, 2000, pp. 163-164; Goddard, Molyneux & Wilson, 2001; International Labour Organization, 2001). Molyneux et al. remark that there “may also be an element of herd behaviour among banks [...] during periods when merger activity is considered fashionable” (Goddard, Molyneux & Wilson, 2001, p. 88).

Overcapitalised banks are faced with demands by their shareholders to grow organically (for example by granting more loans), to grow through value-enhancing acquisitions or simply to pay out the excess capital to shareholders in form of dividends.³⁵ Various analyses show that stronger, i.e. larger and better capitalised, banks tend to take over weaker ones (Berger & Humphrey, 1992; Peristiani, 1993; Vander Vennet, 1998; Wheelock & Wilson, 2000), based on the assumption that the acquired bank's efficiency can be improved.

A study by Buch and DeLong is particularly interesting in the context of this Anglo-German comparative research as it suggests that banks operating in more regulated environments are less likely to be the targets of international bank mergers. Thus, the lifting of regulations could stimulate cross-border bank mergers (Buch & DeLong, 2001).

Dyer et al. argue that there is always an alternative to acquisitions, namely alliances (Dyer, Kale & Singh, 2004). According to Dyer et al. the decision on whether a firm should acquire or form an alliance with another firm depends on five key factors. Management should carefully consider the different kind of synergies between the two firms (modular, sequential, reciprocal), the nature of resources (soft versus hard; i.e. human resources versus machines), the extent of redundant resources (potential for cost-cutting), the degree of market uncertainty and the level of competition.

By illustrating their argument with an example from the banking industry, Dyer et al. advise companies that have to generate synergies by combining human resources to avoid acquisitions (Dyer, Kale & Singh, 2004, p. 112). From their line of reasoning it can be inferred that the more industrialised parts of the

³⁴ On the contrary, “cluster risks” are often the result of mergers and acquisitions. Subsequently, the two banks have to gradually adjust their loan portfolios not to be too exposed to one specific industry or company.

³⁵ Alternatively, the bank could buy back its own shares.

banking business³⁶ are relatively more suitable for acquisition-driven growth strategies than banking operations that are more dependent on a set of specialised individuals (e.g. investment banking).

While size may be useful for realising economies of scale, some companies also enjoy absolute cost advantages which are independent of size. According to Porter (Porter, 1979, 1980, 1998), this is the case in industries where the learning and experience curves are pivotal. It also applies to companies with proprietary technology or a location which enables them to access raw materials.

The emergence of so-called “financial centres” in the banking industry results, among other things, from the importance of a pool of people with particular expertise. The role of London as the dominant banking centre in Europe can be partly attributed to the availability of skilled labour. In contrast, the more dispersed financial services industry in Germany³⁷ could be identified as one reason why Frankfurt seems to remain a second-tier financial city. In addition to an efficient and experienced financial community, a financial centre has to provide economic and political stability, good communications and infrastructure and a regulatory environment that successfully protects investors’ rights without excessive capital market restrictions (Dufey & Giddy, 1978; Gardener & Molyneux, 1993; Falzon, 2001; Schmidt & Grote, 2005).

Access to a pool of well-educated specialists with professional experience can therefore pose an important entry barrier in a service industry such as banking (Schmidt & Grote, 2005). Canals remarks that the experience curve could lead to noticeable cost advantages for some banks (Canals, 1993, p. 189). Production efficiency in banking is often expressed in form of the cost income ratio³⁸ (CIR). The CIR is derived by dividing the non-interest expenses (excluding loan loss provisions) by the sum of net interest income and non-interest income (Golin, 2001, p. 133).

A comparison of cost income ratios shows disparities of up to 30% between Europe’s large banks (Flemings Research, 2000). Smith and Walter hold that

³⁶ For example, retail banking and the credit card business.

³⁷ Cologne/Düsseldorf (e.g. HSBC, Sal. Oppenheim, WestLB, ERGO), Hamburg (e.g. M.M. Warburg, Berenberg), Munich (e.g. HVB Group, Munich Re, Allianz).

³⁸ Also known as the “cost-to-income ratio” or “efficiency ratio”.

the most important factor for differences in cost income ratios are not related to economies of scale or scope but due to operating efficiency. Put simply, they consider the differences in efficiency to be largely the result of better management (Smith & Walter, 2003, pp. 380-381). Other research corroborates these findings (Berger & Humphrey, 1997; Wagenvoort & Schure, 1999; Vander Venet, 2002).³⁹

Another barrier to entry is product differentiation according to Porter (Porter, 1979, 1980, 1998). An established company may enjoy an immaculate reputation or have a recognised brand, which is associated by customers with a specific service, quality or image. So, for a new entrant to overcome existing customer loyalties carries a price. In addition, there can be significant switching costs, i.e. the financial cost to a customer of changing supplier. As remarked by Porter "new entrants must offer a major improvement in cost or performance in order for the buyer to switch from an incumbent" (Porter, 1998, p. 10).

For retail clients, changing their bank accounts is a time-consuming and inconvenient undertaking, which is not done quickly. Besides, a new entrant to the retail banking market would have to build trust and attract customers by offering better conditions as most retail clients have a personal relationship with the bank staff in their local branches and are concerned about their savings and the reliability of their financial transactions. To some extent the same holds true for wholesale banking, particularly the M&A advisory business, where it is common for new entrants without a track record to significantly undercut market prices to attract "deals".

Despite these considerations, it is argued that overall there is little product differentiation within the banking industry (Canals, 1993, p. 191). Product differentiation in retail banking may take the form of an extensive and sophisticated distribution network. Operating a large branch network implies additional fixed costs, but it may also be perceived as an important barrier to entry for potential competitors. As branches are also points of sale for banks, this leads to the fourth barrier to entry, namely access to distribution channels (Porter, 1979, 1980, 1998). Prior to entering a new market, a firm needs to

³⁹ For a review of approaches to measuring banks' productive efficiency see Goddard, Molyneux & Wilson (Goddard, Molyneux & Wilson, 2001, pp. 99-140).

consider ways of distributing its product. Thus, the costs of accessing an adequate distribution network can pose such a financial burden on the company that it would have a competitive disadvantage. This argument could partly explain the reluctance of most European banks to enter the large German retail banking market.

Another important entry barrier in banking may originate from government policies and regulation. Governmental intervention can take many forms, of which government subsidies, regulatory requirements and product standards are just a few. Chapter two analysed at length how EU-wide policies for the banking sector have helped create a level playing field for competitors in this industry. However, the structural differences and the favourable refinancing conditions enjoyed by some banks (e.g. the German savings banks) make it clear that government policies can be pivotal for an industry's competitive environment.

One specific form of government policy which is identified as a distinct barrier to entry in banking comprises capital requirements (Porter, 1979, 1980, 1998; Canals, 1993). Capital requirements in the banking sector have a legal and a microeconomic dimension (Canals, 1993, p. 198). As discussed in the previous chapter, the minimum level of legally required banking capital is set out in the Basle Capital Accords. The microeconomic dimension originates from a bank's need to constantly invest, especially in the latest information technology and the training of its staff to remain competitive.

Although entry barriers tend to improve an industry's profitability (Bain, 1956; Mann, 1966), some research suggests that barriers to entry do not deter new entrants and that there are usually always firms that manage to enter an industry by overcoming these hurdles (Yip, 1982). Moreover, Yip claims that there are actually advantages in lateness. He argues that lateness enables new entrants to enjoy greater flexibility about their positioning. Therefore, they may be able to attack the incumbents' weaknesses and their lateness enables them to use the latest technological equipment, possibly negotiate better terms and conditions with suppliers, customers and employees (Yip, 1982).

An example from the banking industry is the entry of ING Direct, the online banking arm of the Dutch bancassurance firm ING, into various European

retail markets. Supported by large marketing campaigns and attractive conditions for new clients ING Direct grew its deposits⁴⁰ to EUR 197 billion with 15 million customers worldwide within a decade of its establishment in 1997. By avoiding any brick and mortar bank branches ING Direct has been able to keep its cost income ratio below that of most banks in the nine countries in which it has a presence (ING Group, 2006).

⁴⁰ ING calls its client deposits “funds entrusted”.

3.4.3. Analysis of competition among established players in a banking market

Closely related to an analysis of new entrants is an assessment of the level of competition among the existing players. Some industries are characterised by such intense competition that returns do not cover the cost of capital. The more competitive an industry is, the less attractive it is as its profitability declines (Canals, 1993, p. 195).

Porter distinguishes between eight factors that essentially determine the level of competition among established players in an industry: concentration, industry growth, cost structure, product differentiation, diversity of competitors, discrete capacity increases, exit barriers and high strategic stakes (Porter, 1979, 1980, 1998). Applied to the banking industry Canals sees the rivalry within the industry to be specifically driven by a low overall level of product differentiation. Furthermore, he considers a weakening of demand for bank products as detrimental for banks with relatively high fixed costs (Canals, 1993, pp. 194-195).

Industries with few competitors fulfil the criteria of an oligopolistic structure as discussed in the introduction to this section. A high degree of concentration, measured by the market-share of the largest players, also represents a barrier to entry and is usually accompanied by relatively attractive returns on capital.⁴¹ This is, for example, the case in British retail banking which is dominated by HSBC, Barclays, Lloyds TSB, HBOS, RBOS. In contrast, the fragmented German retail banking market suffers from excess capacities and political exit barriers. Büschgen and Börner regard the weak profitability of German banks as a sign of a more competitive spirit in the country's financial services industry, which has abandoned "gentlemanly capitalism" (Büschgen & Börner, 2003, p. 238).

For the politically sensitive banking sector exit barriers can be as important as entry barriers. Exit barriers entail costs such as severance payments and possibly losses from the sale of business units. Moreover, management's

⁴¹ The most common measure of concentration, and the one used by many regulators, is the Herfindahl Hirschman Index (HHI), which is defined as the sum of the squared market shares of all banks in the market (Cetorelli, 1999, p. 2). For a review of approaches to measuring concentration in the banking sector see Cetorelli (1999) or Goddard, Molyneux & Wilson (2001).

initial decision to enter the business may be perceived as a sign of incompetence or misjudgement and affect its willingness to withdraw from a market. Exit barriers can also be politically motivated, if, for example, the industry plays an important infrastructural role or employs a large number of people, who form part of the electorate.

For example, cutting down the number of savings banks is a politically sensitive task as it implies high redundancies among the around 370,000 (2003) employees who work for Germany's savings banks and "Landesbanks". Moreover, German savings banks are an important source of financing for many small and medium-sized enterprises (SMEs) which are the backbone of the German economy. Many of these firms, which are known as the German *Mittelstand*, are highly geared. Thus, a sudden credit shortage could possibly push hundreds of companies to the brink of insolvency (Janssen, 2003).

The level of competition among established players is also conditioned by the degree of homogeneity in the industry. As noted earlier, the banking sector is a relatively homogenous industry in terms of management styles and the products/services offered. The seemingly limited scope for product differentiation therefore poses an additional challenge for incumbents. According to Canals, the intensive price competition in banking is a result of this homogeneity (Canals, 1993, p. 195).

Among the eight factors identified by Porter that determine competition within an industry are the prevailing cost structure and the industry's growth potential. "Slow industry growth turns competition into a market share game for firms seeking expansion. Market share competition is a great deal more volatile than is the situation in which rapid industry growth insures that firms can improve results just by keeping up with the industry [...]" (Porter, 1998, p. 18).

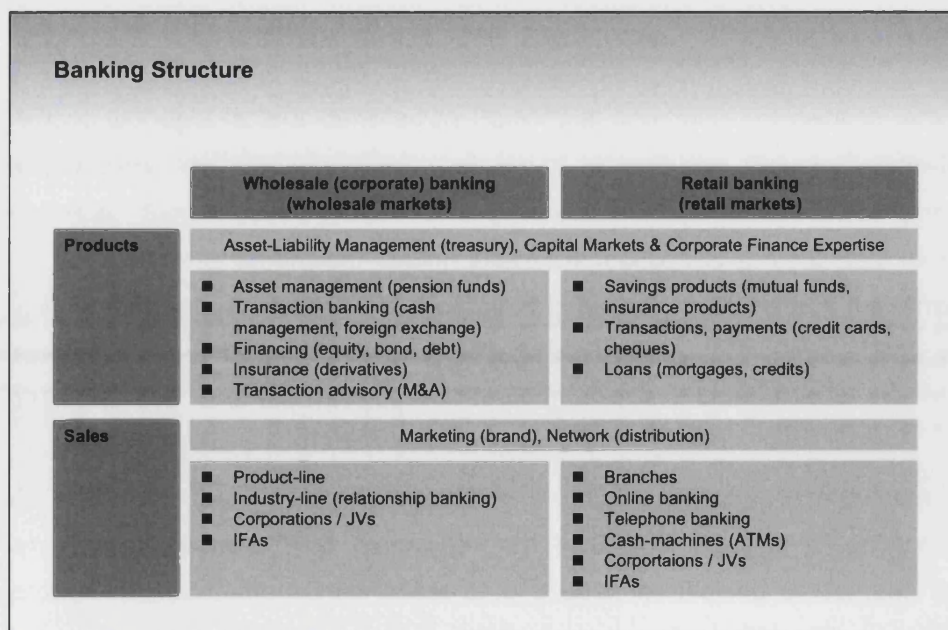
As banks are operationally dependent on the macroeconomic environment in which they operate, their overall performance is a function of economic growth. The aforementioned threat of a sudden weakening of demand for banking products is likely to be of particular concern for banks with relatively high cost income ratios. The reverse holds true for an economic upswing,

which should translate into a noticeable earnings boost for banks with a high proportion of fixed costs relative to variable costs. In that respect Porter's final point about large capacity jumps, which can have disruptive effects on the industry's supply/demand balance could hold true for the banking industry (Porter, 1998, p. 19).

3.4.4. The substitution problem for banking products and services

As described in the preceding paragraphs, companies which operate in industries with attractive returns face the threat of new competitors entering, or at least trying to enter, the same industry. If the new entrants succeed, supply increases relative to demand, so overall profitability should decline. On the other hand, an industry's profitability can also come under pressure if demand declines relative to supply. This is the case when a specific industry's customers discover an alternative source of supply, i.e. if their current needs can be satisfied through a substitute product or service. Porter suggests that pressure from substitute products constitutes a distinct threat for an industry (Porter, 1979, 1980, 1998).

The probability of customers seeking alternative solutions increases if the price/quality relation is perceived as disproportionate. In other words, "the price customers are willing to pay for a product depends, in part, on the availability of substitute products" (Grant, 2002, p. 72). Price elasticity of demand is the relative change in quantity divided by the relative change in price (Varian, 1990, p. 262). Thus demand for a product for which there is a close substitute, can be expected to be very responsive to price changes (Varian, 1990, pp. 262-265).



Demand for the broad range of products and services provided by the banking sector should be subject to different price elasticities due to the varying availability of substitutes. As illustrated in the diagram above, a bank can add value through “production” or through “sales” (advisory services). “Production” refers to the transformation services provided by a bank whereas “sales” comprises essentially non-interest-yielding transaction services.

Substitutability in banking, i.e. in the financial services sector, is characterised by at least two structural shifts (Büschgen & Börner, 2003, p. 235). First, the shift from commercial banking to investment banking, that is the replacement of transformation services by transaction services (disintermediation). Second, it is maintained that there is a shift from bank saving to insurance saving, largely driven by demographic changes in Western countries (Büschgen & Börner, 2003, p. 235). In addition to these two shifts, it is possible to consider a third, which originates from the aforementioned unbundling of “production” of standardised bank products from the “sales/distribution” of these products.

According to Bryan, non-branch-based distribution channels should gain significance for retail banks (Bryan, 1993). While telephone and online banking are services that can be offered by traditional retail banks, it is more difficult for them to credibly sell third-party products if substitute products are also available from the same group. Nevertheless, many banks operate this type of “open architecture” as they feel obliged to offer their clients a wider choice of products.

The limited credibility of these open-architecture approaches helps independent financial advisors (IFAs) to compete with the advisory and sales service of retail banks. IFAs usually cooperate with various product partners (banks, asset managers and life insurers) and are paid on commission basis. Cooperation with IFAs reduces a bank’s fixed costs as demand for branch staff declines, while the profit margin per product sold normally decreases by the amount of commission paid to the IFA.⁴²

⁴² Another substitution threat in retail banking may come from transfer payments, which are carried out through the use of credit cards issued by non-banks rather than as remittances (less common in Europe than in the USA). However in many cases banks themselves are issuing credit cards, thus this possible threat of substitution has been internalised.

On the product side, a retail bank faces a threat of substitution from investment alternatives which are not managed outside its scope. These may be, for example, mutual funds managed by non-bank financial institutions (e.g. Fidelity Investments). If, however, these third-party funds are sold through the bank, then the bank receives commission from the asset manager.⁴³

Effectively, any investment (including deposit or savings accounts) that is not managed by a bank can be regarded as a potential substitute. This may range from such obvious investments as life insurance products or real estate to expenses (investments) for education and training.⁴⁴ The product group least at risk of substitution in retail banking is the loan and mortgage business as this requires the capacity (size for risk diversification) and technology for asset-liability management.

In wholesale banking, companies' direct access to capital markets is the most obvious substitute. As described in the previous chapter, disintermediation, i.e. the substitution of bank loans and deposits through direct interaction with other market participants, poses a threat to banks which only offer transformation services and no transaction services. However, Bryan remarks that there are limits to securitisation, which should ultimately allow banks to concentrate on a kind of "residual transformation business" (Bryan, 1993). This core business is likely to comprise only transformation services for individual households and small and medium-sized enterprises where the costs of securitisation exceed their value (Bryan, 1993).

Customers' interest in substituting bank financing by capital market financing have caused many banks to expand their service spectrum to include capital market services. In some countries, like the USA, this strategic shift had to be preceded by some legal changes, notably the Gramm-Leach-Bliley Financial Services Modernization Act of 1999 which repealed the Glass-Steagall Act of 1933.

If a bank offers transaction services in addition to transformation services, its core competence stretches from mere asset-liability management skills to corporate finance and capital markets expertise. The concept of a company's

⁴³ For example, if HSBC sells a retail fund managed by US asset manager Fidelity via one of its branches, HSBC will receive a fee from Fidelity, which will be shown in its "commission income".

“core competence” is at the heart of Hamel and Prahalad’s resource-based views (Hamel & Prahalad, 1990), which are discussed in section five.

Banks’ wholesale clients could also consider using insurance companies for certain services. Most importantly, insurance companies in the field of asset management and corporate pension schemes could replace banks. The imminent pressure on most European governments to promote funded pension schemes requires companies to offer their employees retirement savings plans. The structural change in European demographics entails altered financing of provision for old age. This trend has contributed to the creation of bancassurance conglomerates, with Allianz/Dresdner Bank and Lloyds TSB being the two most prominent cases in Germany and Britain.

On the sales side, the scope for substitution of distribution to wholesale/corporate clients appears limited as the corresponding banking products are far more customer-specific than retail banking products, which tend to be relatively standardised. However, some large consultancy companies have made inroads on the strategic consulting of the M&A advisory business, monitoring the transaction process for their clients.

⁴⁴ “Consumption” and “cash holdings” could even be considered substitutes for banking services.

3.4.5. The bargaining power behind a bank's asset-liability management

An industry's profitability is also determined by the relative bargaining power of buyers on one hand and sellers on the other (Porter, 1998, pp. 24-29). Porter holds that a buyer enjoys a relatively strong negotiating position if few concentrated buyers purchase large volumes of the sellers' output (Porter, 1998, p. 24). Purchasers' readiness to negotiate better conditions is even greater if the products procured represent a significant proportion of their total costs. Moreover, it is argued that purchasers in low-margin businesses are more price-sensitive than those with lucrative margins, who are more willing to pass on a proportion of their profits to suppliers (Porter, 1998, pp. 24-26).

Related to the argument about product substitution is the view that the relative bargaining power of buyers is stronger if the products procured are fairly homogenous. This is especially true if a buyer can swiftly change from one supplier to another, without high switching costs. In an extreme scenario, the buyer considers replacing the supplier with its own production, i.e. through "insourcing", or as Porter calls it "backward integration" (Porter, 1998, p. 25). However, what holds true for buyers, may as well apply to sellers if the reverse circumstances prevail - that is, if sellers are in a better negotiating position for the same reasons.

Applying Porter's analytical five forces framework to the banking sector requires some modifications with respect to the assumptions about the interdependence of buyers and suppliers. Contrary to the situation for industrial firms, there is no clear understanding of what constitutes a bank's input and output. It is agreed that there is no coherent theory that explains the "production" process of a bank (Hartmann-Wendels et al., 2000; Goddard, Molyneux & Wilson, 2001; Büschgen & Börner, 2003). However, there are two auxiliary models that can be of use for the analysis of competitive forces in the banking industry (Hartmann-Wendels et al., 2000, pp. 77-79).

The *production approach* (Gilligan, Smirlock & Marshall, 1984; Hartmann-Wendels et al., 2000; Goddard, Molyneux & Wilson, 2001) considers deposits and loans as outputs. Output is measured by the number of accounts and transactions, yet without taking into account business volumes. This method

counts only the operating costs as inputs and not the interest expenses of a bank (Hartmann-Wendels et al., 2000, p. 714). As the transformation services of a bank are not captured by this method, it is at best suitable for transaction banks, i.e. investment banks.

The *intermediation approach* is more applicable for explaining the input/output relation of a bank's transformation services (Sealey & Lindley, 1977; Hartmann-Wendels et al., 2000; Goddard, Molyneux & Wilson, 2001).⁴⁵ It is suggested that a bank's deposits are the input and its loans are the output (Hartmann-Wendels et al., 2000, pp. 77-79). Although this approach intuitively appears reasonable and is accepted in a modified version as a proxy for the following analysis about competitive forces in the banking sector, it is not entirely unproblematic.

One difficulty of the intermediation approach is that it does not take into account the different sizes and maturities of loans and deposits, thus it ignores two principal transformation characteristics (Hartmann-Wendels et al., 2000, pp. 77-79). Other authors criticise the fact that banks cannot "procure" deposits and that the value chain from deposits to loans cannot be easily established (Büschgen & Börner, 2003, pp. 29-32). The latter objection does not seem to assume that the number and volume of deposits should rise if the interest rates for these deposits are relatively more attractive compared to alternative investments.⁴⁶ Berger and Humphrey criticise the intermediation approach and show that deposits and loans are outputs if they add value for a bank. This is the case if the returns on an asset exceed the opportunity costs, or if the costs of a liability are less than the opportunity costs (Berger & Humphrey, 1992).⁴⁷

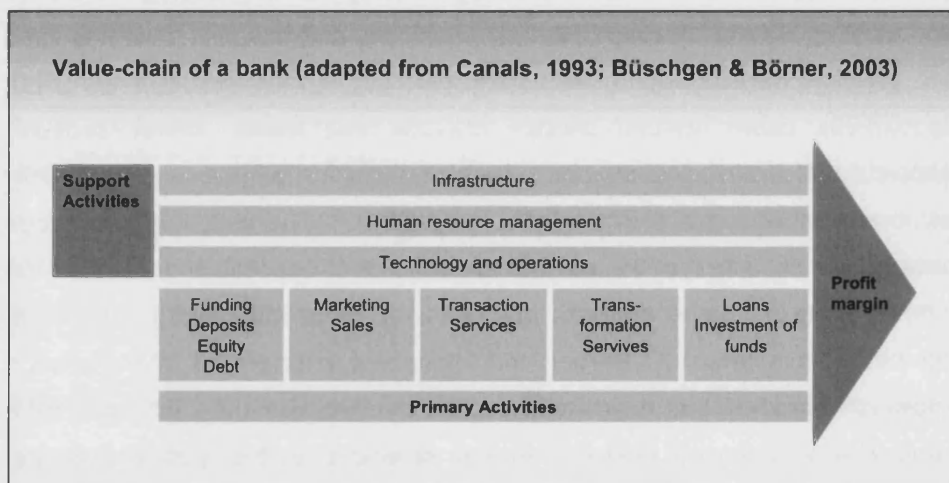
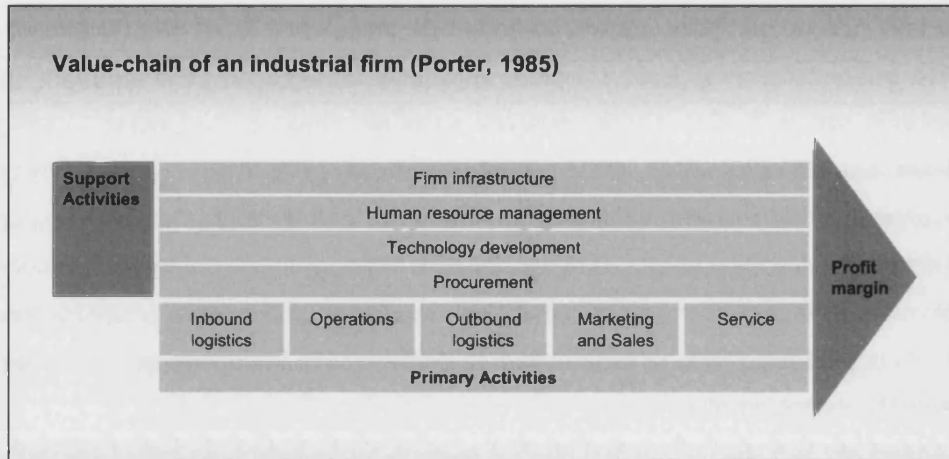
Despite these reservations about the intermediation approach, both Büschgen and Börner (Büschgen & Börner, 2003, p. 39) and Canals (Canals, 1993, pp. 198-199) adapt Porter's value-chain model (Porter, 1985) for the banking sector, thus implicitly accepting the premises of the intermediation approach. The principal difference between Porter's model (as depicted the diagram below) and the bank-specific version is the integration of "procurement" as

⁴⁵ The intermediation approach is of little, if not no use for transaction banks.

⁴⁶ This also comprises interest rates paid by competing banks.

⁴⁷ For a detailed literature review on efficiency measurement in banking see e.g. Goddard, Molyneux & Wilson (2001).

part of a bank's basic activities. Procurement is understood as the raising of capital, which constitutes an integral element of a bank's asset-liability management (Büschgen & Börner, 2003, p. 39; Canals, 1993, pp. 198-199).



The intermediation and production approaches are both derived from a bank's balance sheet, thereby missing or inadequately reflecting several value-adding activities of a bank. Instead, a bank's output could also be defined as its total operating income, while its inputs are total operating expenses and risk provisions. Consequently, a bank's profit is the most condensed efficiency indicator, which offers comparable efficiency ratios in relation to the bank's equity (ROE) or assets (ROA).

Assuming a knowledge of the price sensitivity of deposits, it could be argued that banks can (and should!) actively manage the volume of deposits.

Moreover, in the following paragraphs it is argued that a bank's total equity and liabilities (i.e. shareholders' equity, debt/bonds and deposits) – not just deposits – need to be taken into account for a competitive input/output analysis.

Although the liability side of a bank's balance sheet finances its assets, which largely comprises loans, it should not be assumed that deposits "cause" loans (Howells & Bain, 2002, p. 33). "It is not the case that banks receive large numbers of small short-term deposits which they then convert into loans of a different scale and maturity" (Howells & Bain, 2002, p. 33). Rather, banks respond to a demand from clients for financing by offering loans. As Howells and Bain rightly note, "customers simply do not go into a bank 'demanding' deposits" (Howells & Bain, 2002, p. 33). Given that demand for deposits originates from a bank's need to diversify its financing structure, one may link the liabilities side of the balance to the "supplier" and the asset side to the "buyer".

For banks that provide transformation services, i.e. deposit-taking institutions, clients are "suppliers" and "buyers". In wholesale and retail banking, a client can either be reflected on the asset, the liability or both sides of the bank's balance sheet, depending on whether the client is a debtor (asset side), a creditor (liability side), or both. A bank that offers transformation services has essentially three different means of financing its assets. First, the owners of a bank provide equity (shareholders' equity). Second, the bank attracts customers' deposits. Third, the bank can raise debt through issuing various kinds of bonds. All three means of financing are subject to different terms and conditions, with varying maturities and claims (liabilities). These differences are reflected in different "prices" (interest) a bank has to pay for those funds.

Thus, a bank's refinancing costs are a function of its liabilities and equity structure. Differences in the refinancing structure imply different interest rate sensitivities, as, for example, bond prices may react faster to interest rate changes than deposits. The different refinancing strategies are essential for a bank's profitability and show in the bank's net interest margin. At the four German banks researched for this thesis, net interest income contributed on average 53% to operating income between 1993 and 2003. In the case of the

four British banks analysed, net interest income comprised on average 55% of operating income for the same time span.

A bank's bond and equity refinancing conditions are essentially a function of the interest rate environment but also of its risk profile and overall financial strength. Established credit rating agencies such as Standard & Poor's, Moody's and Fitch assess a bank's financial strength. A bank can strengthen its capital basis by raising equity. Perpetual or subordinated bonds are occasionally referred to as "hybrids" and may be recognised as equity by the credit rating agencies. Subsequently this could lead to a better "financial strength rating" and improve the bank's refinancing conditions.

The costs, i.e. the interest a bank has to pay to its depositors is largely dependent on the liquidity and the returns of comparable asset classes (given a specific risk and liquidity), which should be ultimately also a function of the interest rate environment. Retail clients may to some extent accept relatively less favourable conditions for their deposits and savings in return for an attractive network of services.

Retail clients' relative bargaining power, regardless whether they are "sellers" or "buyers", is limited due to the high concentration of banks on one side and the disproportionately large number of retail clients on the other. Moreover, retail clients face relatively high switching costs (measured in terms of opportunity costs) when they change their bank, as it affects a wide range of existing contracts (Klemperer, 1987; Vives, 1991). Still, a retail client's relative bargaining power vis-à-vis the bank increases with personal wealth. For this reason, banks distinguish between different wealth categories among retail clients, with the few high-net-worth individuals enjoying better conditions than some companies.

Analogously to the arguments put forward regarding substitution, the relative bargaining power of wholesale clients increases along with their ability to raise finance directly on the capital markets, for example, by issuing bonds. To what extent a firm can achieve better financing conditions on the capital markets than from a bank depends largely on its size, businesses, diversification, profitability and overall financial strength, expressed by its credit ratings.

Advising firms on their optimal financial structure is a service provided by a bank's corporate finance team. With the exception of very large multinational corporations, most firms do not have their own corporate finance team. Thus firms which prefer to finance their operations directly through the issuance of debt or equity still require external capital markets expertise, a service offered by banks in return for commission fees. Although disintermediation is an option for wholesale clients, the choice between bank and capital market financing does not necessarily strengthen their negotiating position vis-à-vis the banking sector, given that most banks offer both transformation (loans) and transaction (capital market) services.

Although wholesale buyers do not have the option of completely circumventing the banking sector, they still enjoy a relatively strong negotiating position for standard products, for example, ordinary bank loans. Since such plain products do not leave much room for differentiation, they can be easily compared and essentially differ only with regard to price. The limited scope for product differentiation of many standard bank products makes the personal relationship between the bank's employees and its clients a decisive business factor. It is in the context of a bank's differentiation strategy that relationship banking is of increasing significance. Traditionally, relationship banking was an integral part of the transformation process and served the purpose of monitoring the borrower. Due to the growing significance of disintermediation, relationship bankers are likely to become increasingly sales-oriented key account managers, offering the bank's transaction and transformation services (Leahy, 1997; Boot, 2000).

If the client does not demand a standardised product but is confronted with a problem and seeks a solution, then the bank should be in a position to offer differentiated, sophisticated, thus distinct financial concepts. By offering solutions as opposed to specific products, the price becomes a subordinated competitive criterion - not least, because complex solutions are difficult to compare. Given that transaction-related services allow for much product differentiation, numerous relatively small and specialised corporate finance houses⁴⁸ can maintain a competitive edge without necessarily having to be the cost-leader among their peers.

⁴⁸ For example, the small German M&A boutique Drueker & Co advised Procter & Gamble on the EUR 6.6 billion acquisition of Wella AG, a producer of hair-care products, in 2003.

Product differentiation is among the three potentially successful generic strategies for coping with the five competitive forces identified by Porter. In addition to product differentiation, Porter considers “cost leadership” and “focus” as the other two viable means of establishing a strategic advantage (Porter, 1998, p. 35). For a firm and its products to be perceived as unique, it can employ several means. Among the key drivers recognized in the academic literature are: product features and product performance, complementary services, intensity of marketing activities, technology embodied in design and manufacture, quality of purchased inputs, procedures influencing the conduct of each activity, skill and experience of employees, location and the degree of vertical integration (Porter, 1985, pp. 124-125; Grant, 2002, pp. 288-289).

Büschgen and Börner argue that differentiation strategies are not particularly prominent among banks, albeit they seem to be more viable than cost-leadership approaches (Büschgen & Börner, 2003, p. 240). The homogenous and standardised character of many financial products challenges banks to differentiate their products to such an extent that their clients perceive them as unique.

Product differentiation comprises every aspect that relates to the client, including the client’s perception. Consequently, product differentiation should enable a firm to obtain a price premium that exceeds the additional costs of providing the differentiation (Porter, 1985, p. 120; Grant, 2002, p. 277; Büschgen & Börner, 2003, p. 240), thereby establishing a competitive advantage. Ultimately, product differentiation needs to create value for which the client is willing to pay.

Particularly in retail banking, a bank’s image and reputation is thus of great importance as clients cannot easily assess the varying qualities of banks, other than on the basis of the product price and service quality (Neven, 1990; Grant, 2002, p. 293). In addition to the aforementioned relatively high switching costs, a bank’s good reputation could hence prevent retail-banking clients from changing to a new bank with an unrecognised brand-name.

A firm's uniqueness is also determined by its set of resources and assets, which it should combine to create something that is valued by the customer and which only this constellation of assets can provide. Section five "A bank's resources determine its core competence" elaborates these ideas in detail. The uniqueness of each firm should facilitate its goal of occupying an exclusive niche. Therefore, a company that is sufficiently different should always have 100% of its market-share according to Henderson (Henderson, 1989).

Cost leadership is identified as an alternative strategic approach in successfully dealing with the aforementioned competitive forces. In this way, a firm aims to produce and market identical or similar products more efficiently than its competitors. A stringent cost-leadership strategy that entails achieving a low cost relative to competitors becomes the dominant theme for the entire firm (Porter, 1998, p. 35). Ultimately, the cost leader of an industry should deliver the highest profits and can therefore invest more to further enhance its efficiency. Cost leadership can be established through economies of scale and scope, technological superiority, a more advanced learning curve, high market share and privileged access to input factors (Porter, 1998, pp. 35-37).

In the context of the banking industry, the cost leadership strategy could gain significance for banking businesses that are increasingly dominated by information technology (see e.g. Goddard, Molyneux & Wilson, 2001, pp. 141-165). The more standardised retail banking sector should benefit most - with the development of online-banking pointing in this direction. However, for parts of the banking business that rely on a personal client relationship, such low-cost strategies are likely to remain the exception.

By concentrating on a specific market segment (e.g. customer, location, product) a firm pursues a strategy that should ultimately result in a differentiation or low-cost strategy. Porter regards the "focus-strategy" as the third viable option in coping with competition (Porter, 1998, pp. 38-40). "The strategy rests on the premise that the firm is thus able to serve its narrow strategic target more effectively or efficiently than competitors who are competing more broadly. As a result, the firm achieves either differentiation from better meeting the needs of the particular target, or lower costs in serving this target, or both" (Porter, 1998, p. 38).

Applied to the banking industry there are various examples where such an approach seems to have paid off. Many Swiss banks have for many years pursued a strategy whereby they have focused on serving the world's wealthiest individuals with exclusive personal financial advice. The Swiss banking sector developed an expertise in dealing with this clientele and advanced processes geared specifically to the private banking sector. Despite high personnel costs and international pressure to curtail offshore banking, Swiss banks have remained highly competitive overall. Focused strategies are also in place where a bank segments its clients according to client groups and geography. In wholesale banking, this leads often to matrix structures as part of a relationship-banking approach.

It is noted that transactions usually involve a combination of products ("hardware") and services ("software"), which can be separately differentiated (Mathur, 1984; Kenyon & Mathur, 1997). In mature markets, products gradually turn into commodities and services are increasingly provided by specialised companies. Therefore, mature markets facilitate the unbundling of "hardware" from "software" (Mathur, 1984; Kenyon & Mathur, 1997; Grant, 2002, p. 289).

In the financial services industry certain players also focus on just one part of the value chain. This can be illustrated by the emergence of firms that exclusively concentrate on the distribution of financial products (financial planners) or pure asset managers, which do not operate their own distribution network (e.g. most hedge funds). Deutsche Bank's board member Lamberti argues that the continuous industrialisation of banking requires banks to concentrate on only few specialised core businesses from a financial services firm's value chain. He considers, for example, that commodity-type back-office services and the maintenance of a bank's information technology could be outsourced. The usual size of these operations is too small (i.e. too expensive) to remain an integrated part of the in-house value chain (Lamberti, 2004).

In accordance with Lamberti's argument, Canals considers specialised banks as strategically superior to universal banks (Canals, 1999). Canals' line of reasoning effectively follows a "resource based view" as he emphasises that increased "competition in each segment of the financial market will lead each

bank to focus on those activities where it has the right resources and capabilities and where it can develop sustainable competitive advantages" (Canals, 1999, p. 569). Among other things, he considers the withdrawal of British banks from investment banking in the mid-1990s as evidence of the trend towards specialisation (Canals, 1999, p. 569).

Canals points out that an important force driving the banking industry towards specialisation originates from investors' demand to reveal the allocation of capital for each business unit within a banking group. A bank's different business units compete for the group's capital on the grounds of varying economic performances. Shareholders expect management to allocate capital among business units according to their efficiency. Consequently, each business unit is autonomously responsible for the capital it receives (Canals, 1999, p. 569).⁴⁹

In practice this idea led to the development of the increasingly popular concept of "economic value added" (EVA). EVA is a tool for measuring financial performance, by subtracting an appropriate charge for the opportunity cost of all capital invested in an enterprise from the net operating profit (Stewart, 1999).⁵⁰ As a result of this opportunity cost approach to a company's profitability, it is difficult for management to justify cross-subsidies between business units for a substantial length of time. Canals argues that "as a result, cross-subsidies between business units that currently exist in many universal banks will tend to disappear, since senior managers in each unit will not want to be responsible for capital not allocated specifically to them or which is devoted to financing other, less profitable activities within the banking group" (Canals, 1999, p. 569).

Canals' third reason for arguing that specialisation could become more prominent among banks in a financially integrated Europe is that "the growth in the size of the market accompanying the euro will allow for scale economies specific to each business" (Canals, 1999, p. 569). This argument is consistent with Walter and Smith's observation that economies of scale may exist in certain business lines, such as asset management, but are more difficult to

⁴⁹ The author of this doctoral research would strongly agree that increasing pressure from investors (e.g. shareholders) for management to reveal the shareholders' equity allocation to different business units can be observed. The telephone conferences between investors and Allianz' management regarding the group's capital allocation for Dresdner Bank in 2002 and 2003 may suffice as anecdotal evidence.

realise for a group of different business units (Walter & Smith, 2003, pp. 377-379).

It should, however, be borne in mind that the term “specialisation” is a potentially misleading one as the degree of specialisation remains a relative concept. At the heart of the specialisation debate is the measurement of economies of scope and the question whether the combination of two business activities can be more efficiently carried out than if they existed as stand-alone units. “Economies of scope are cost savings arising when a bank produces two or more outputs using the same set of resources, which result in the costs for the group of goods or services being less than the sum of the costs if they were produced separately” (Goddard, Molyneux & Wilson, 2001, p. 85). Therefore, the underlying issue is the composition of a financial services firm’s value chain.

The bancassurance model can illustrate the notional difficulty of “specialisation”: if a retail bank acquires an insurance company, does that bank broaden or simply deepen its retail financial services? One may as well ask whether a retail bank is already too diversified if it operates its own branches and sells its own mutual funds (retail funds). Another example is the intersection of investment banks and reinsurance companies in the field of risk transfer and integrated risk management (i.e. what is known as insurance-based investment banking). Investment bankers and reinsurance managers share an interest in sophisticated risk-management solutions and have a cultural affinity with one another. A convergence, in the form of cooperation and competition between investment banks and reinsurance companies can already be observed (Franzetti, 2002). For example, several US investment banks have moved into the reinsurance business.⁵¹

These examples demonstrate that specialisation should be analysed with regard to the efficient use of resources within a value chain and not necessarily in the context of diversification. However, the feasibility of unbundling products and services also facilitates the repackaging of “hardware” and “software” – not least to satisfy the demands of more sophisticated customers who seek differentiation advantages. A case in point

⁵⁰ EVA = Net operating profit after tax (NOPAT) – [capital x cost of capital] (Stewart, 1999).

from the financial services sector is unit-linked life insurance, which combines term life insurance with an investment fund chosen by the client – alternatively, the client could also buy both products separately.

Grant points out that the relatively modest success of many “one-stop-shopping” strategies of financial services companies questions to what extent bundling creates customer value (Grant, 2002, p. 289). Yet bundling of transformation and transaction services seems to be a viable strategy for banks to address the substitution threat from disintermediation, while balancing the earnings volatility of investment banking.

Applying Porter’s analytical tools to buyers’ and suppliers’ relative bargaining power in the banking sector illustrates that a bank can strengthen its competitive position vis-à-vis its wholesale clients by offering transformation and transaction services. While transaction services allow for greater product differentiation, the more standardised transformation services are more price-sensitive and need to be embedded in a network of banking services.

In order to better understand a bank’s relative bargaining power, this research assumes that a bank’s liabilities are its inputs and that its assets are its outputs, despite the previously elaborated conceptual difficulties of the intermediation approach. Although this modified intermediation approach serves the purpose of comprehending the competitive forces in the banking industry, it must not be overlooked that the profitability of a bank’s transformation services results from managing the interdependence between a bank’s assets and liabilities.

The significance of a bank’s asset-liability and risk management is illustrated by considering how its refinancing conditions deteriorate if its loan portfolio is, for example, burdened by non-performing loans. Thus, a bank’s refinancing conditions are not just determined by the structure of the liabilities side of its balance sheet, but also by the quality of its assets. Similarly, a bank cannot offer competitive conditions for loans if its refinancing costs are too high. For this reason, the profitability of a bank’s transformation services is often

⁵¹ Goldman Sachs owns Arrow Reinsurance Company, Lehman Brothers has set up Lehman Re and Morgan Stanley has a stake in Enterprise Re.

expressed by the net interest margin.⁵² Since the profitability of a bank's transformation services is greatly determined by its risk and asset-liability management, the capability of optimising the interaction of a bank's balance sheet should be understood as one of its core competence.

⁵² Net interest income is the difference between gross interest income (from the bank's assets) and interest expense (from its liabilities), i.e. the cost of funds. The net interest margin is the return on average earning assets, calculated by dividing net interest income by average earning assets (Golin, 2001, p. 703).

3.5. A bank's resources determine its core competence

The importance of a firm's core competence for its competitive strategy is put forward by Hamel and Prahalad (Hamel and Prahalad, 1990). According to Hamel and Prahalad, core competence is about collective learning in the organisation and "should make a significant contribution to the perceived customer benefits of the end product" (Hamel and Prahalad, 1990, p. 84). Subsequently, the emergence of core competencies should enable the firm to access a wide variety of markets as the focus is on capabilities rather than products (Hamel and Prahalad, 1990).

The writings of Hamel and Prahalad (1989, 1990, 1993) can be understood in the tradition of what Mintzberg describes as the "learning school of strategic" management (Mintzberg et al. 1998). The learning school traces its roots to policy analysis and is closely related to the work of Charles Lindblom on the incremental nature of the policy process (Lindblom, 1959, 1979).

As the title of his article "The Science of 'Muddling Through'" (Lindblom, 1959, 1979) suggests, Lindblom believes that successful policy-making simply aims at 'muddling through' more effectively and that there is no clear distinction between means and ends. In the Popperian tradition of 'piecemeal social engineering' (Popper, 1960, 1985), Lindblom argues that policies are directed at a problem and that any implementation reveals the policy's weaknesses. Consequently, "the policy" has to be modified and a successive implementation brings further flaws to light. An ongoing process of trial and alteration should eventually resolve the problem.

Lindblom describes incrementalism as a process that is more concerned with solving a problem than with seizing certain opportunities (Mintzberg, et al. 1998). The lack of a deliberate direction or a collective perspective (Mintzberg, et al. 1998) is addressed by Quinn, who proposes the modified concept of "logical incrementalism" (Quinn, 1978, 1980a, 1980b, 1989).

Essentially, Quinn argues that "managed or 'logical' incrementalism is not the 'disjointed incrementalism' of Lindblom, or the 'garbage can' approach of Cohen et al., or the 'muddling' of Wrapp and others. It demands conscious

process management. It often involves a clear, thoroughly analyzed vision and set of purposes. But it also recognizes that the vision could be achieved by multiple means and that it may be politically unwise, motivationally counterproductive, or pragmatically misleading and wasteful to specify a particular set of means too early in the strategic process. It also recognizes that both the strategic program and the vision itself may be improved by incremental changes as new information becomes available. To believe or act otherwise is to deny the value of new information" (Quinn, 1989, p. 56).

As remarked by Mintzberg et al., Quinn's logical incrementalism complements Lindlom's original thoughts on aspects taken from the design school and emphasises the role of conscious learning (Mintzberg, et al. 1998, pp. 180-182). Thus, Quinn paves the way for the prominent concepts of Hamel and Prahalad, which maintain that strategy is a function of learning and learning essentially depends on capabilities. Hamel and Prahalad consider a firm's competitive advantage to be largely determined by its core competence which is again dependent upon its resources and capabilities (Hamel & Prahalad, 1990).

An organisational structure that fosters communication and cooperation across divisional boundaries promotes the development of the company's core competence as intangible resources and capabilities are enhanced as they are applied and shared. Hamel and Prahalad consider core competence to be the glue that binds existing businesses and the engine for new business development. Moreover, it provides the patterns of diversification and market entry (Hamel & Prahalad, 1990). Since each firm has a unique set of resources and capabilities this constellation of intangible assets should form the basis for a firm's strategy, making it difficult for competitors to imitate (Hamel & Prahalad, 1989, 1990, 1993).

In order to leverage an organisation's core competence Hamel and Prahalad also introduce the concept of "strategic intent" which encapsulates the firm's general direction, providing orientation and an objective for the entire organisation. Strategic intent is about consistently focusing on essentials, motivating staff and leveraging limited resources.

Hamel and Prahalad challenge the conventional concept of “fit”. Originating from the contingency approaches to organisation theory, the concept of fit in strategic management usually refers to the consistency of a company’s organisational structure with the industry environment for its strategy to be successful (Lawrence, & Lorsch, 1967; Grant, 2002, p. 316). According to Hamel and Prahalad, strategic intent creates an extreme misfit between resources and ambitions, implying a noticeable stretch for the organisation. They suggest that leveraging resources is as important as allocating them, thus they claim that their proposed concept of ‘stretch’ supplements the idea of ‘fit’ (Hamel & Prahalad, 1993).

This view is shared by Senge (1990) who holds that “leadership in a learning organization starts with the principle of creative tension” (Senge, 1990, p. 9), whereby creative tension emerges as the gap between where the organisation wants to be and the realistic assessment of where it currently stands. Hamel and Prahalad postulate that a critical component of resource leverage is determined by a firm’s ability to maximise the insights gained from everyday experience with clients, competitors and products. They conclude that some companies are better than others at extracting knowledge from those experiences (Hamel & Prahalad, 1993, p. 80). Hamel and Prahalad go one step further than Senge by arguing that it is not sufficient to be a learning organisation, but that a company must also be capable of learning more efficiently than its competitors (Hamel & Prahalad, 1993).

The results of learning are translated by an organisation into innovation, thereby bringing their resources and capabilities to the market. It is argued that banks are relatively averse to innovation (Büschgen & Börner, 2003; Börner, 2000), which could be a sign of their learning difficulties. Büschgen and Börner suggest that banks’ risk aversion seems to impede their willingness to innovate (Büschgen & Börner, 2003; Börner, 2000). Moreover, financial products are easily copied, as reflected by their high degree of homogeneity. Thus, innovative banks cannot maintain their competitive edge for long on the basis of mere product differentiation, which does not incentivise banks to innovate.

However, innovative approaches in banking based on the bank’s resources and capabilities offer a viable strategy to cope with the homogenous nature of

most banking products. Therefore innovation has not only to anticipate the needs of clients and to be the first to offer solutions for these problems (Canals. 1999, p. 573), but more importantly to differentiate the means of bringing the product to the client. Banks can best protect themselves against imitators by developing a unique set of resources, with a constellation of employees and technologies that cannot be replicated easily.

For Shaw, competition among banks is essentially a technology battle (Shaw, 2001, pp. 1-18), which only a few can survive. Technological superiority is of particular significance for transformation services. It is argued that the speed and accuracy of transformation services can be unique features of banks that are not effortlessly copied (Börner, 2000; Shaw, 2001; Büschgen & Börner, 2003). For transaction services technological leadership is less relevant and can be compensated by specific market expertise (e.g. product or geographical) that is perceived by clients who are willing to pay for it as adding value.

The proponents of this so-called resource-based view⁵³ of strategic management focus on an organisation's resources and capabilities and internal structure for establishing a competitive advantage. It is argued that "[...] in a world where customer preferences are volatile and the identity of customers and the technologies for serving them are changing, a market-focused strategy may not provide the stability and constancy of direction needed as a foundation for long-term strategy. When the external environment is in a state of flux, the firm itself, in terms of its bundle of resources and capabilities, may be a much more stable basis on which to define its identity. Hence, a definition of the firm in terms of what it is capable of doing may offer a more durable basis for strategy than a definition based on the needs that the business seeks to satisfy" (Grant, 2002, p. 133).

Furthermore it is put forward that, due to the increasing internationalisation and deregulation, competitive pressure has intensified within most sectors, leaving only a few industries protected from severe competition (Grant, 2002, pp. 136-137). Hamel notes that according to a MCI/Gallup poll a majority of CEOs consider the strategies of their competitors to have converged during the 1990s (Hamel, 1997). This however calls for more unique strategies and

differentiated approaches. Subsequently it pinpoints the necessity for more managers to go against the current, withstanding the collective pressure to do the conventional - or as put by Hamel: "It takes leaders who question conventional wisdom" (Hamel, 1997, p. 70).

In contrast to the arguments presented by the resource-based view, the positioning school emphasises the industry structure and considers resources merely as one input factor which is subject to the same competitive forces as any other input factor. Porter encounters the criticism of the resource-based school by acknowledging that the value of resources and capabilities is inextricably bound to strategy (Porter, 1998, p. xv). However, he also rightly points out that "resources, capabilities and other attributes related to input markets have a place in understanding the dynamics of competition, attempting to disconnect them from industry competition and the unique positions that firms occupy vis-à-vis rivals is fraught with danger" (Porter, 1998, p. xv).

From the few academics who publish research on banking strategies, it is mainly Börner who extensively discusses the diverse strategic management concepts in the context of banking (Börner, 2000). Börner contrasts the understanding of strategy derived from industrial organisation economics (Porter) with the resource-based view (Hamel & Prahalad) and concludes, in agreement with Mintzberg, that these two schools should be regarded as complementary. He considers the market positioning approach and the resource-based view as compatible and proposes a "client group / resource matrix" for the strategic analysis of banks (Börner, 2000).

Recognising the market for "resources and capabilities" as an important component of the competitive environment is most evident in the banking industry. For example, in investment banking London enjoys a relative competitive advantage over other European cities as it is home to a large pool of experienced and specialised investment bankers which in turn enables it to attract young and well-educated graduates from all over the world. Therefore, in addition to the aforementioned competitive forces, which determine the relative bargaining power of buyers and sellers, labour should be highlighted

⁵³ Occasionally also referred to as the learning school (Mintzberg et al., 1998).

as a distinct input factor, not least to also emphasise the service character of the banking business.

Unlike proponents of the resource-based view, Porter's focus on industry structure and products assumes clearly defined markets and industries (Grant, 2002, pp. 86-87). Grant notes that a "market's boundaries are defined by substitutability, both on the demand side and supply side" (Grant, 2002, p. 86). Porter responds to his critics by conceding that there can be ambiguity about where to draw industry boundaries, but that "one of the five forces always captures the essential issues in the division of value" (Porter, 1998, p. xv). It is argued that Porter's model "defines an industry "box" within which industry rivals compete, but because competitive forces outside the industry box are included – entrants and substitutes – the precise boundaries of the industry box are not greatly important" (Grant, 2002, p. 87). Moreover, Kenyon and Mathur argue that a specific product can serve different needs, thus the market is effectively defined in a bottom-up approach by the customer (Kenyon & Mathur, 1997; Grant, 2002).

This can be illustrated by examples from banking. Assume a bank's commercial client may be interested in insuring the value of its exports to another country (e.g. the USA). If the firm expects the US dollar to fall, it would buy US dollar put options against its domestic currency (e.g. against euros), thereby safeguarding the right to sell its US dollars in return for euros at an agreed rate. The same firm could also buy euro call options to achieve the same result. Another client considers buying the same product, i.e. US dollar put options as part of an investment portfolio in anticipation of negative US budget deficit numbers. Alternatively, the same investor could express a bearish view of the US economy by short selling the Dow Jones, i.e. all shares on this index. An infinite number of examples could be provided, showing that customers do not choose markets but solutions to problems – thus a top-down definition of a market seems of limited use for the analysis of strategic management.

3.6. Banking: the link between micro- and macrostructures

Criticism about how the relevant industry, thus the relevant market, is defined is further enriched by a lively academic debate about the significance of industry structure for a firm's performance. In Porter's model, which emerged from the industrial organisation school, industry structure is central to a firm's profitability. This assumption is challenged by proponents of the resource-based view, who argue that a company's performance is largely influenced by unique organisational processes. Although the question of the extent to which industry matters is pivotal for the analysis of strategic management, the few existing empirical studies seem to offer different answers (Schmalensee, 1985; Rumelt, 1991; McGahan & Porter, 1997; Hawawini, Subramanian, Verdin, 2000).

Empirical research by Rumelt suggests that "stable industry effects account for only 8 per cent of the variance in business-unit returns" (Rumelt, 1998, p. 105). A study by McGahan and Porter (McGahan & Porter, 1997) indicates that industry effects account for 19 percent of the aggregate variance in profitability. Research by Hawawini, Subramanian and Verdin (Hawawini, Subramanian & Verdin, 2000) confirm the mixed picture as the totality of its sample shows that the industry effect is very small on firms' economic value added, whereas if the least and most profitable companies are excluded from the sample, then the overall industry effect significantly increases. Porter remarks on the debate about the significance of the industry structure for competitive strategies that "it is hard to concoct a logic in which the nature of the arena in which firms compete would not be important to performance outcomes" (Porter, 1998, p. xv).

By comparing British and German banking strategies over a decade this research also attempts to understand whether there are national patterns which could be attributed to profoundly different industry structures. The prevailing cooperative and savings bank landscape in Germany, which contrasts sharply to the market structure in Britain, calls for such an investigation. Moreover, this research addresses the significance of the changing European financial system as the bank's principal playing field, i.e.

the relevance of European financial integration as an environmental factor. Yet, unlike the quantitative empirical works of Schmalensee (1985), Rumelt (1991), McGahan and Porter (1997) and Hawawini et al. (2000), this thesis pursues a multiple longitudinal case study approach to understanding the realised corporate strategies of banks. A balanced qualitative and quantitative approach to researching patterns over a substantial length of time should deliver less ambiguous data than a mere quantitative analysis based on incommensurable data. The following chapter on methodology deals with these issues in detail.

The significance of industry structure for competitive analysis is also illustrated by the varying sensitivities of competitors to decisions of their peers. As Porter notes, the structure determines the basic parameters within which competitive moves are made (Porter, 1998, p. 91) and he adds that “a company may have to change its strategy if there are major structural changes in its industry” (Porter, 1996, p. 78).

For obvious reasons Porter needs to concede that structure does not entirely determine the workings of a market and that there is still room for different strategic moves (Porter, 1998, p. 91). Unfortunately, it remains unclear with Porter how much strategy matters and to what extent strategies are somehow “pre-determined”. Unlike this thesis, which is informed by Giddens’ concept of structuration (see introduction and chapter on methodology), Porter does not sufficiently address the interrelatedness of a system with its principal entities which through their interaction constitute the system and determine the structure.

However, Porter maintains that “in most industries, competitive moves by one firm have noticeable effects on its competitors and thus may incite retaliation or efforts to counter the move; that is, firms are mutually dependent” (Porter, 1998, p. 17). Consequently, Porter introduces an oligopolistic market structure of the type elaborated in section four of this chapter. Despite elaborating different offensive and defensive competitive moves he subscribes to Sun Tzu’s (Sun Tzu, 1963) dictum that the best strategy is to prevent the battle in the first place and that “ideally, a battle of retaliation never begins at all” (Porter, 1998, p. 92). Subsequently, he favours strategic approaches that do not threaten competitors’ goals.

An important contribution to the analysis of a firm's competitive environment, which recognises the co-existence and cooperation of competing parties, is put forward by game theorists Brandenburger and Nalebuff (1995, 1996). Their concept of co-opetition is widely accepted as complementing Porter's five forces model (Grant, 2002, pp. 90-91). Co-opetition takes into account that buyers, suppliers, and producers of complementary products do not only interact as competitors, but may also work cooperatively with each other. Even Porter acknowledges Brandenburger and Nalebuff's concept as "the most important single contribution" (Porter, 1998, p. xiii).

Brandenburger and Nalebuff (1995, 1996) point out that in addition to the widely recognised interdependencies between customers, suppliers and competitors a company needs to consider complementors as a distinct group among the players of a "business game".⁵⁴ As most businesses have to compete as well as to cooperate, the authors suggest using the term co-opetition. Co-opetition emphasises to perceive the interdependencies of these players from an allocentric as opposed to an egocentric viewpoint. This should allow players to better recognise win-win as well as win-lose opportunities.

An egocentric framework measures a point in space with respect to an object, ego, i.e. the company's own position. In contrast, allocentric, also referred to as geocentric, is a concept of locating points within a framework external to the holder of the representation and is independent of his or her position (Klatzky, 1997). By introducing cooperation into the competitive analysis Brandenburger and Nalebuff add another dimension to Porter's framework. Moreover their emphasis on an allocentric framework links classic game theory to complexity theory (for a review of complexity theory in management studies, see e.g. Anderson, 1999).

The notion of co-opetition is closely related to the term "collective strategy" introduced by Astley and Fombrun in an earlier work about automatic teller machine networks in the financial services industry (Astley & Fombrun, 1983). As a result of strategic alliance building, strategic outsourcing and the growing

⁵⁴ "A player is your complementor if customers value your product more when they have the other player's product than when they have your product alone. A player is your competitor if customers value your product less when they have the other player's product than when they have your product alone" (Nalebuff, 1996).

significance of networks (see e.g. Lamberti, 2004), clearly discernable organisational boundaries seem to gradually disappear, while new complexities are emerging.

Game theory can help explain competitive interactions among firms. According to Grant, these theoretical constructs allow the framing of strategic decisions and provide a structure for analysis (Grant, 2002). Hence, game theory facilitates predicting the outcome of competitive situations which depend on the choices made by other players (Black, 1997; Varian, 1990), using probability calculus.

The essential strength of game theory for everyday strategic management lies in the need to identify the true interests of the other players before “playing the game”. In order to apply game theory the decision-maker needs to identify the hidden agendas of the other relevant participants, assess their capabilities and recognize their priorities. Thus, game theory can be a powerful tool, as it requires decision-makers to analyse their competitors (Porter, 1998, p. 91). Once the decision-maker has made the right assumptions by adequately assessing the underlying interests and capabilities of its competitors, the viable options can be better identified and predictions can be made more accurately.

In a market with few players, i.e. in an oligopolistic market structure, game theory seems to be of greater use and its concepts can be applied in a more straightforward way. For the analysis of the relatively consolidated British banking industry game theory could offer more insights than for the fragmented German market, in which the decision of one player is unlikely to have the same impact on its competitors than would be the case in Britain. Consequently, as consolidation of the European banking market proceeds, the application of game theories could become more prominent.

The importance of precisely identifying competitors' true interests is also at the heart of what Mintzberg calls the “power school” of strategic management (Mintzberg et al., 1998). The “power school” considers strategic management as “an overt process of influence, emphasising the use of power and politics to negotiate strategies favourable to particular interests” (Mintzberg et al., 1998,

p. 234). Mintzberg distinguishes between micro and macro power, as power relations surround and infuse organisations.

The micro power school investigates the play of politics as part of the strategy process within an organisation (Pettigrew, 1973, 1977; Macmillan, 1978; Majone & Wildavsky, 1978; Cressey et al., 1985; Macmillan & Guth, 1985). An organisation's capability to learn and to react to change is, among other things, determined by its efficiency in finding an internal consensus. These vital issues for a firm are addressed by the micro power school. An example of micro power research from the banking industry is a study by Boeker and Hayward on conflicts of interest in investment banking. Boeker and Hayward conclude that banks' corporate finance teams have power over equity analysts and influence their ratings (Boeker & Hayward, 1998).

In contrast, the macro power school focuses on the use of power by an organisation, which is recognised as a unitary actor (Pfeffer & Salancik, 1978; Porter, 1979, 1980; Astley & Fombrun, 1983; Brandenburger & Nalebuff, 1995, 1996). Hence, the macro power school deals with the organisation and its environment and is related to the positioning school. From a macro power perspective corporate strategy deals with the demands and requirements of suppliers, buyers, interest groups, competitors, regulators and other external groups which influence or can potentially influence the workings and the profitability of a firm (Mintzberg et al., 1998, p. 248). Notwithstanding the great importance of the micro power school, this research concentrates on decisions taken by an organisation within its environmental context and thus stands in the tradition of the macro power school.

The relevant environment for banks is the financial system, as discussed in chapter two. It is recognised that financial markets and the banking sector mutually determine their structures and jointly constitute the overall structure of the financial system. In order to understand how industry structures affect competition, Grant suggests studying past developments, which possibly allow the discernment of patterns of corporate strategy, competition and profitability (Grant, 2002, p. 83).

Pfeffer and Salancik (Pfeffer & Salancik, 1978) argue that an organisation can either adapt to the prevailing environment, so that its resources and

capabilities fit the conditions, or it can attempt to change the environment according to its resources and capabilities. Their reasoning seems in accordance with Schmidt's argument that a financial system is a configuration of its subsystems, which features a coherent structure (Schmidt, 2001).

As elaborated in the second chapter, Schmidt considers such a coherent system as relatively resistant to structural change (Schmidt, 2001, p. 21). Therefore he proposes that a financial system might need to be "sufficiently destabilised" in order to change its structure (Schmidt, 2001, p. 21). This leads to the question of which forces and which agents are sufficiently powerful to initiate and to handle such structural changes, which would possibly induce systemic instability. Ultimately, Schmidt's argument evolves into a relative macro power game of banks trying to drastically alter their corporate strategy in order to attain a better competitive position, whilst contributing to the transformation of the financial system.

Linking Schmidt's ideas (Schmidt, 2001) with those of Pfeffer and Salancik (Pfeffer & Salancik, 1978) paves the way for the following chapter on methodology and the conduct of long-term corporate level case studies. Informed by Giddens' concept of structuration (Giddens, 1984) the next chapter elaborates the interrelatedness of the macro- and micro-structure and critically discusses the structure-conduct performance paradigm. Effectively, it ties together the macro-level approach from the second chapter with the micro-level findings of this chapter, which hence should be recapitulated before turning to the next chapter on methodology.

This chapter has served two purposes: first, it has clarified the notion of strategy and, second, discussed prominent strategic management theories in the context of the banking industry. Strategy in this research is understood as a pattern of realised corporate decisions that have structural implications for the organisation. Porter's strategic management theory about competitive forces has been discussed in the context of the banking industry and contrasted with the strategic management theory of Hamel and Prahalad about a company's core competence. Brandenburger and Nalebuff's game theoretical concept of co-opetition has complemented the review.

4. Research philosophy and methodology

4.1. Introduction

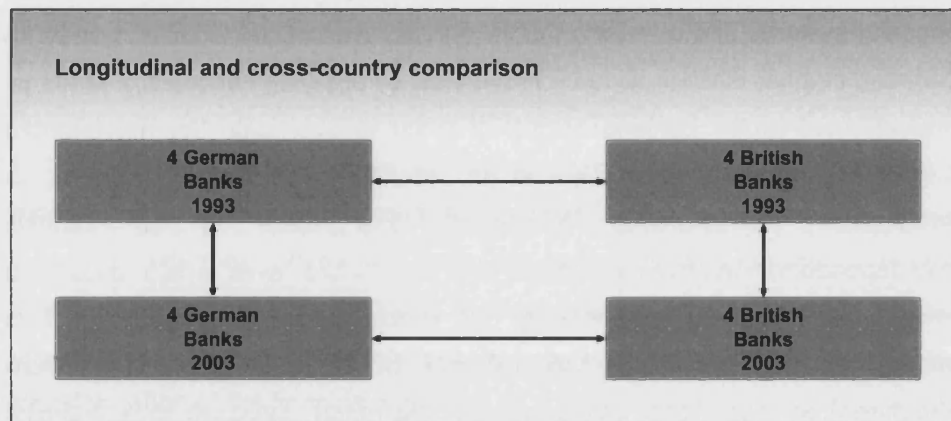
Chapter two of this research reviewed the integration process of Europe's financial systems and offered a macro perspective to bank-specific issues. In contrast, chapter three provided a micro view by applying concepts of strategic management to the banking sector. In order to overcome the micro/macro divide, this research subscribes to an ontology described by Giddens as structuration. Structuration recognises that there is an intrinsic interdependence between the micro and the macro level, which should be recognised in the methodology of social science research. This interdependence shows in the function of banks (representing micro structures) as institutions that determine the macro structure of a financial system.

This research assumes that corporate strategy is a reality that can be observed. Despite its inductive methodology, which is often ascribed to a constructionist perspective (Easterby-Smith et al., 2002, p. 30), this research pursues an empirical approach in the tradition of the positivist paradigm. As remarked by Easterby-Smith et al. it is rare for researchers to uphold a pure epistemological approach; often a mixture of different viewpoints is used. In fact, the ontological concept of structuration implicitly recognises the danger of methodological dogmatism and calls for "methodological anarchy" (Feyerabend, 1975) by bridging the micro and macro perspectives.

Consequently, this research neither pursues a mere micro approach, in the form of a single in-depth case study, nor a macro approach with a large aggregate data set. The empirical investigation is a longitudinal comparative case study and the period analysed stretches from the beginning of the Single European Market in 1993 until the end of 2003.

For two reasons it appears pertinent to analyse this period. First, in 1993 the European Common Market was launched, entailing wide-ranging changes for the financial services industry in the following years. Banks had to adapt to this changing legal and macroeconomic environment. Strategic adjustments at

large financial institutions require several years to be implemented and to show results. Second, the time between 1993 and 2003 spans one full business cycle in Britain and Germany. The business cycle, measured as real GDP growth (year-on-year), is an important indicator of the macroeconomic conditions in which banks operate.



The purpose of this research is to empirically show why banking integration during the first decade of the Single European Market remained slow. More specifically, it seeks to explain

- A) how and why British and German banking strategies differed in an increasingly integrated European economic system and
- B) why market liberalisation seems to have provoked two fundamentally different strategic reactions among banks, neither of which appears to have significantly promoted European banking integration.

Given the framework of this research, the answer to the interesting, but separate question as to why certain strategies prevailed over others will inevitably remain somewhat tentative. It is argued that an understanding of why one specific strategy was pursued and others not would require a detailed knowledge of each bank's decision-making processes and organisational structure for the time between 1993 and 2003, which would entail an entirely different, albeit equally valid and interesting approach. However, the focus of this research is not decision-making processes and issues of organisational behaviour, but rather to comprehend the British and German banking

landscape through the changed positioning of four of the largest players in each market.

In order to strengthen the validity of this research, different methods are used to study the realised strategies of banks. Triangulation is achieved through two qualitative methods with two different data sources and one quantitative method using a third set of data. The two qualitative methods are archival research and a three-stage survey of the LexisNexis database. As a bank's principal commodity is money, its activities are discernible from its income statements and balance sheets. Thus, this research considers the banks' income statements and balance sheets as important sources of information about the banks' realised strategies. Comparable ratios from the banks' income statements and balance sheets provide the basic quantitative data. Combining these methods and sources should also help to overcome the institutional memory problem, which is typical of longitudinal case studies.

The qualitative information used in this research includes strategies announced by management. However, this research is cautious about assuming that announced strategies are identical to management's truly intended strategies. It is understood that "signalling" constitutes an important strategic tool, which banks with "market power", in particular, may use for their own interests.

Interviews fulfil only a supplementary function where the other sources do not present a clear picture. The subordinated role of interviews results from the decision to analyse the realised corporate strategies of publicly listed banks as opposed to emerging business strategies of non-listed institutions. As previously elaborated, corporate strategy is concerned with the scope of a firm in terms of industries, markets, diversification, allocation of equity and corporate resources, etc. whereas business strategy deals with establishing a competitive advantage for a defined product/client matrix.

Corporate strategy involves the allocation of resources and capital to such an extent that it implies a structural shift for the organisation, which cannot be easily reversed - put simply, corporate strategy refers to decisions which have to be approved by the board of directors. Since corporate strategies can imply substantial structural, financial and legal consequences, the owner of the firm

ought to be informed. Thus, management of publicly listed companies has to inform shareholders about the firm's corporate strategy. Insofar, all relevant strategic decisions are publicly known and an interviewee can only provide limited additional information.

This chapter is organised as follows: In the next section, the ontological concept of this research is elaborated. This is necessary to understand the multi case study methodology chosen. Section three elaborates the epistemological difference between strategy and strategic management. This is followed by a review of case studies as a means of building theory. The three different methods that comprise the triangulation approach used in this research are set out in the fifth section. The chapter concludes with a note on the author's professional background and a summary.

4.2. The ontological perspective – bridging the micro/macro divide

This research acknowledges the interdependence of an agent with its structure (environment). Consequently, it is also recognised that any unit consists of subunits and that this unit itself forms part of a larger entity, i.e. a system. Reality is thus the linkage of systems with each other. In order to come to terms with the complexity of reality the researcher must focus on only a few levels of reality and their interconnectedness. This approach assumes that the analysed system is not further disaggregated, while the other, the “higher” system is not subsumed into another system, i.e. further aggregated.

In the case of this research, banks are not broken down into organisational units (business segments), or individual decision-makers. Instead, each bank is considered as a “unitary actor” within the European financial system. Moreover, the European banking system is neither studied in the context of the global financial system, nor subsumed into the world economy. In order to demonstrate the interaction between actors and their environment it has to be accepted that the actors analysed are not further disaggregated, hence the decision to concentrate on corporate level strategies. These systemic boundaries are a premise of this research.

In order to come to terms with the interdependence between actors and structure, the sociologist Giddens puts forward the concept of structuration (Giddens, 1976, 1979, 1984). Giddens offers an ontological approach that encapsulates the interrelatedness of actors and structure. He argues that the relationship between actors and structure results from repetitive action, reproducing the structure (Giddens, 1976, 1979, 1984).

Giddens distinguishes between systems and structures. For him systems are the actualised patterns over time and space, understood as reproduced practices. Structures are sets of rules and resources implicated in the institutional articulation of social systems (Giddens, 1984, p. 377). “Analysing the structuration of social systems means studying the modes in which such systems, grounded in the knowledgeable activities of situated actors who draw upon rules and resources in the diversity of action contexts, are produced and

reproduced in interaction [...] The constitution of agents and structures are not two independently given sets of phenomena, a dualism, but represent a duality" (Giddens, 1984, p. 25).

According to Giddens, any social structure constrains and enables the actors. He recognises that social action requires structure and that structure is the result of social action. Thus, individual actors can change the prevailing structure by deviating from existing paths. For him, structure and action are an integral part of social reality. He emphasises that the duality of structure and action constitute reality and that any social study should acknowledge this interdependence.

Giddens' structuration theory addresses his concern that most studies of social interaction either focus on the micro- or the macro-level, thereby insufficiently taking into account the unintended consequences of one level for the other. "The opposition between 'micro' and 'macro' is best reconceptualized as concerning how interaction in contexts of co-presence is structurally implicated in systems of broad time-spaced distancing – in other words, how such systems span large sectors of time-space. And this in turn is best investigated as a problem of the connection of social with system integration [...]" (Giddens, 1984, p. xxvi).

For Giddens time and power are both reflected by jointly understanding action and structure, as they presuppose each other (Giddens, 1979). "The existence of power presumes structures of domination whereby power that "flows smoothly" in processes of social reproduction [...] operates" (Giddens, 1984, p. 257). Giddens defines power as the capacity to achieve outcomes (Giddens, 1984, p. 257). He does not view power as an obstacle to freedom or emancipation but as its medium, although he concedes, "it would be foolish to entirely ignore the constraining properties of power" (Giddens, 1984, p. 257).

Giddens' theory of structuration offers an ontological perspective that appears pertinent for understanding the process of European integration as well as corporate strategy. Giddens argues that "social integration has to do with interaction in contexts of co-presence. The connections between social and system integration can be traced by examining the modes of regionalization which channel, and are channelled by, the time-space paths that the members

of a community or society follow in their day-to-day activities. Such paths are strongly influenced by, and also reproduce, basic institutional parameters of the social systems in which they are implicated" (Giddens, 1984, pp. 142-143).

Applied to the realm of corporate strategy Giddens' concept of structuration is in accordance with the dictum that "strategy is structure" occasionally ascribed to Tom Peters (Peters, 1984; Grant, 2002, p. 189) and in contrast to Chandler's statement that "structure follows strategy" (Chandler, 1962). The theory of structuration thus strengthens the argument that strategy cannot be separated from its environment and that strategy formulation and implementation are closely intertwined, hence it follows an understanding of strategy as process (Clausewitz, 1997; Mintzberg et al., 1998).

The importance of power in Giddens' concept of structuration also complements the understanding of strategy as a process. The relative power of actors becomes pivotal for the interdependence between agent and structure. An actor's ability to alter the prevailing structure depends upon its resources and positioning, thus its power within the structure. This reasoning appears consistent with Schmidt's previously elaborated argument that a financial system is a configuration of its subsystems, which complement each other and that the coherence of such a system renders it resistant to structural change (Hackethal & Schmidt, 2000; Schmidt, 2001). In order to overcome systemic rigidity, a few actors need to become sufficiently powerful to change the structure according to their interests.

In economic theory, Giddens' concept of structuration finds its parallels in the structure-conduct-performance paradigm (SCP). The SCP paradigm originates from "industrial organisation" research which is primarily associated with the works of Mason and Bain (Mason, 1939, 1949; Bain, 1951, 1956, 1959). Unlike traditional microeconomists, Mason and Bain followed an inductive approach to theory building about the interaction of firms and industries, which led to the SCP paradigm (Goddard, Molyneux & Wilson, 2001, pp. 34-39).

The SCP paradigm recognises the link between industry structure and the conduct of the firms that comprise an industry. An industry's structure is determined by the number and size of firms, the degree of product

differentiation, the extent of vertical integration and the type of entry and exit barriers (Goddard, Molyneux & Wilson, 2001, pp. 34-39). Pricing policies, advertising, research and development are among the firms' conduct as well as the decision to cooperate or collude with each other. The early versions of the SCP paradigm assumed that firms' conduct was conditioned by the industry structure and that conduct would not affect market structure (Goddard, Molyneux & Wilson, 2001, pp. 34-39).

The modified SCP paradigm which recognises that conduct may also change structure (Phillips, 1976; Scherer & Ross, 1990) paves the way for strategic considerations, as demonstrated by Porter's five forces framework (Porter, 1980). Porter applies the SCP paradigm to understand industry-level factors that influence the performance of firms. In fact, Porter's claim to fame rests upon modifying findings from industrial organisation for the analysis of corporate strategy and introducing it to managers. With the help of this analytical tool, strategies can be developed to take advantage of the prevailing industry forces.

4.3. Strategy and strategic management: an epistemological distinction

The previous chapter discussed Porter's five forces framework and Hamel and Prahalad's notion of core competence as well as other established strategic concepts in the context of the banking industry. It was argued that the banking industry, overall, can be analysed with the same strategic management tools as other industries. However, none of these strategic management theories is grounded in the banking sector, so theories may possibly be of limited suitability to explain the particular embeddedness of large banks as institutional pillars within such a politically sensitive environment as a financial system. A theory that is grounded in the banking industry through empirical research may be better suited to understanding the specific strategic issues facing banks.

The empirical nature of this research, which entailed collecting data about British and German banks, links it to the positivist school of epistemology. It shares with positivism the belief that these developments can be measured and mapped and that the facts gathered are objective knowledge, regardless of the perspective or interaction of the observer. Easterby-Smith et al. note that the principal assumption of positivism is "that the social world exists externally, and that its properties should be measured through objective methods [...]" (Easterby-Smith et al., 2002, p. 28).¹

It is also positivistic insofar as it provides an abstraction from the world of everyday experience (Crotty, 1998, p. 9). The condensed analysis of eight banks over a decade allows identification of the "big picture", which is necessary to correctly evaluate long-term trends. A longitudinal study of this type also smoothes particular developments which could be the result of mere luck rather than good strategic management. It is assumed that a company's success or failure would be the result of smarter management over a certain period. As noted by Grant, "central to the rational approach to strategy analysis is the idea that we can systematically analyze the reasons for

¹ To illustrate this argument, consider Deutsche Bank's acquisition of Bankers' Trust. This takeover is a documented transaction which can be quantified, e.g. through the acquisition price, the volume of assets, the number of employees and the altered structure of assets. Thus, the actual transaction leaves little room for interpretation, whereas the question of the extent to which this deal was value-enhancing is a subject for discussion.

business success and failure and apply this learning to formulating business strategies" (Grant, 2002, p. 27).

A principal assumption of positivism is that the observer is independent from what is being observed. In contrast to the positivist paradigm, constructionism represents an epistemological view that denies that there is objective truth (Berger & Luckman, 1966). Constructionists believe that truth and meaning emerge only in interaction with the realities. As Crotty puts it, "meaning is not discovered, but constructed", (Crotty, 1998, p. 9). For a social constructionist, reality is determined by people rather than by objective and external factors (Easterby-Smith et al., 2002, p. 30).

Given the positivist character of this research there needs to be clarity about the meaning of strategy and strategic management as theories. Strategies have to be unique, whereas strategic management provides a general framework for specific strategies to be developed. Strategic management is about how to manage the strategy process. For example, Porter developed a theory about strategic management which concentrates on a company's understanding of its competitive environment. Others, like Hamel and Prahalad, have presented a theory about the significance of an organisation's resources and capabilities for gaining a competitive advantage. Both are theories about strategic management from which concrete strategies can be derived.

Consequently, one may conclude that it is possible to develop theories about strategic management, whereas strategies themselves cannot be theories. Strategies are not theories on the grounds that a strategy can only be tested in a particular situation for which it was conceived, hence any repetition is impossible. The understanding of strategy as a concrete process and the implicit lack of testability dismisses the idea that strategies are theories. It is rather suggested that strategies use analytical concepts to adequately evaluate current circumstances in order to optimally advance specific interests.

Distinguishing between strategic management and strategies may also offer a solution to the aforementioned problem of how to differentiate a "strategy" from a "non-strategy", given that strategies cannot be falsified. The answer

may be that strategies can only be assessed by the realised outcome. The success, respectively the failure of a strategy can be ultimately established by evaluating the outcome and identifying the principal decision-maker.

The realised outcome does not reveal much about a specific strategy as it cannot be repeated, but it does indicate something about the quality of the decision-maker ("strategist"). A successful outcome proves that the strategist was right in evaluating the circumstances and launching, implementing and monitoring the appropriate measures to meet his/her interests. The decision-maker's interests have to be aligned with those of the owners through contractual agreements (principal-agent problem). This view assumes that even the most incremental strategy process allows some discrete developments to be identified and decision-makers to be held responsible - it is not all about "muddling through".

Therefore, the issue is not about "strategy" or "non-strategy", but about good or bad strategic management, whereby the understanding of good and bad is defined by the owners and creditors of a firm. Segal-Horn concludes that "analysis is a necessary but not a sufficient condition for strategic thinking. Strategic thinking is about making judgements which are then translated into decisions. Judgements are not context-free and neither is strategic decision-making. Ultimately it depends on exercising judgement" (Segal-Horn, 1998 p. 13).

This pinpoints another crux of strategic management, namely to what extent should strategies be formulated and communicated outside the mind of the manager or the board room? It is a valid strategic move not to communicate strategies if this serves the purpose of achieving an objective. Besides, the analysis of a strategy communiqué does not reveal whether the communiqué is an essential part of the strategy (for example, the announcement of price cuts, sends a clear message to competitors and to clients) or whether it is merely intended to inform (or misinform). Yet, even an inadvertent message can cause competitors to react. This strengthens the argument that the answer to the question why certain strategies are pursued by management and others will remain somewhat tentative. It also illustrates that the researcher should carefully question strategic statements made by management.

For the strategy analyst ignorance about the true meaning of corporate communication can lead to the wrong conclusions about what was intended. The intended strategy cannot be known for certain, whereas the realised corporate strategy is observable. It should be considered that the communication of corporate strategy is subordinated to the overall strategy, as communication itself constitutes a powerful strategic tool. Possibly, strategy is only communicated to such an extent as it actually serves the ultimate objectives identified by management. In a similar vein, Porter recognises the importance of strategic signalling as a strategic means (Porter, 1980).

While it is argued that only 10-30 percent of intended strategies get realised (Grant, 2002, p. 26), it may still be assumed that the principal corporate decisions are the result of "strategic deliberations" by management. However, this premise bears a certain danger. A potential pitfall of this research is that some measures that altered the course of one of the banks analysed had not been intended as a major strategic leap forward. Developments which in retrospect appear as strategic may in fact be the outcome of mere coincidences or the combination of various fortunate and unfortunate circumstances. If these outcomes are perceived as successful, then they are afterwards considered "strategic"; if not they were usually the mistakes of the previous management.

Despite the awareness of possible misinterpretation of outcomes as strategic, this research focuses on realised "strategies", assuming that any corporate decision that implies structural shifts in a bank's organisation, earnings, assets or liabilities is strategic in nature. For example, Deutsche Bank's decision to buy Bankers' Trust in 1998 is an observable fact, which had repercussions for the bank's assets and income structure and can be unambiguously understood as a measure to expand into the US investment banking market. While a single decision and its implications can be recorded, it does not yet say much about the quality or soundness of such a strategic move. Ultimately, it is the level of profitability and earnings stability that indicates the quality of a corporate strategy. Put simply, if an established firm is not profitable, its strategy has been wrong.²

² As it is impossible to demonstrate the absence of a strategy, the only plausible conclusion is that the strategy must have been incorrect.

4.4. Case studies – a means of theory building

Longitudinal case studies can serve to develop new theories about strategic management. It is argued that case studies are ideal for theory building as they are a prime source of large and rich data sets (McCutcheon & Meredith, 1993; Voss et al. 2002). Eisenhardt holds that theory building from case study research is particularly suitable for new areas of research (Eisenhardt, 1989, p. 532), such as the strategic management of banks.

Literature on theory building presents a broad range of approaches to case study research. With their work on grounded theory, Glaser and Strauss (1967) and Strauss (1987) paved the way for an inductive methodology of theory building. However, their pivotal understanding of “fieldwork” is of limited use when it comes to the study of realised corporate strategies in the banking sector due to the difficulty of establishing a clear input/output relation and the rather abstract nature of most services provided by banks.³

More applicable is the guidance offered by Yin about how to design and conduct case study research (Yin, 1994). Yin defines a case study as an “empirical inquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident” (Yin, 1994, p. 13). Yin’s structure is complementary to Miles and Huberman’s (1984) approach. They describe techniques for analysing qualitative data through coding and thus provide methods for dealing with the complexity of rich data.

The structure of this research draws on the approaches presented by Eisenhardt (1989) and Voss et al. (2002) who set out a sequential approach for conducting case research. Eisenhardt points out that a well-defined research question is necessary for systematically collecting data. She remarks, “a priori specification of constructs can also help to shape the initial design of theory building research” (Eisenhardt, 1989, p. 536).

³ Most bank activities are uncountable and therefore not observable through fieldwork. For example, it is difficult to observe the trading activities of a proprietary trader who might significantly contribute to the bank’s revenues. Although specific trading techniques can be discussed, the two relevant dimensions of trading, namely risk exposure and profit, can be measured but not observed in the sense of “fieldwork activity”.

The question underlying this research is: why did market liberalisation provoke two fundamentally different strategic reactions among banks, neither of which appears to have promoted banking integration. In order to develop a theory that may answer this question, a longitudinal comparative case study method is pursued. As noted by Pettigrew, “the longitudinal comparative case method provides the opportunity to examine continuous processes in context and to draw in the significance of various interconnected levels of analysis” (Pettigrew, 1990, p. 271).

This research looks at eight of the largest publicly listed banks in the United Kingdom and Germany. The banks analysed are HSBC, Barclays, Lloyds TSB, Royal Bank of Scotland, Deutsche Bank, Dresdner Bank, Commerzbank and HVB Group. The fact that these banks are publicly listed is of great relevance as it facilitates the availability of information on their corporate strategies. The choice of British and German banks represents two relatively extreme positions within the European banking landscape. However, as remarked by Pettigrew if only a limited number of cases are analysed then it is preferable to select extreme situations (Pettigrew, 1990). The theory derived from studying British and German banks could subsequently be tested against other European banks.

What follows is a two-phase case analysis as described by Eisenhardt (1989). The first step is a within-case analysis, which facilitates handling enormous volumes of data. The aim of within-case analysis “is to become intimately familiar with each case as a stand-alone entity. This process allows the unique patterns of each case to emerge before investigators push to generalise patterns across cases” (Eisenhardt, 1989, p. 540). The resulting structure of the research in the form of stand-alone case studies also helps readers make their own assessment of the theory. The second step ties together all eight cases in order to identify cross-case patterns through the construction of an array (Voss et al., 2002).

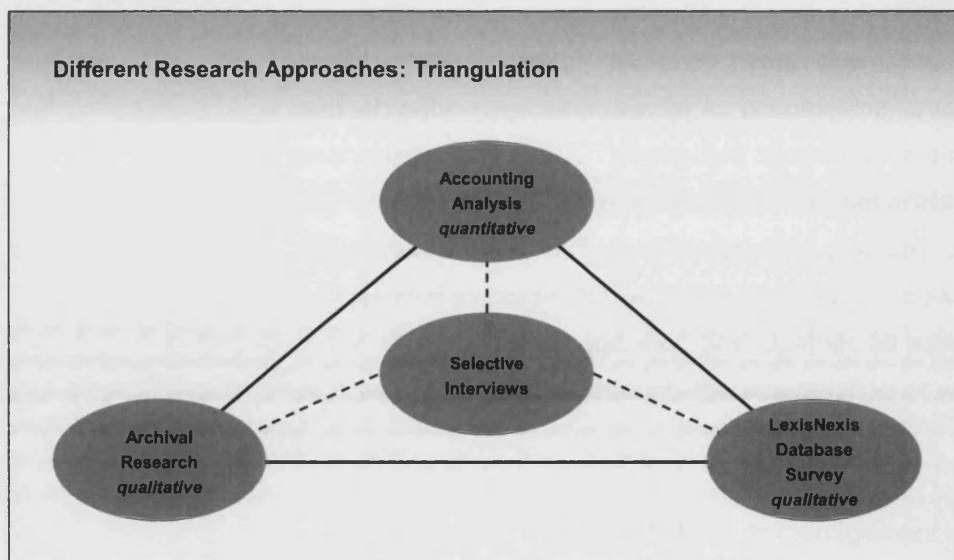
The aim of this research is to develop a theory about strategic management in banking which has to be testable and logically coherent. In the tradition of replication logic, the theory is tested against evidence from each case study (Yin, 1994). Replication logic, that is “the logic of treating a series of cases as a series of experiments with each case serving to confirm or disconfirm the

hypotheses” (Eisenhardt, 1989, p. 542), strengthens the validity of the relationships.

4.5. Triangulation

Within the concept of validity, a further distinction can be drawn between “construct validity”, “external validity” and “internal validity” (Voss et al., 2002). Construct validity is “the extent to which we establish correct operational measures for the concepts being studied” (Voss et al., 2002, p. 211). Internal validity is the extent to which a causal relationship can be established, whereby certain conditions are shown to lead to other conditions. External validity is used to describe whether the findings of a study can also be generalised beyond the immediate case study (Yin, 1994, pp. 32-37).

Voss et al. hold that the use of multiple case studies may reduce the depth of studies when resources are constrained, but can augment external validity (Voss et al., 2002, p. 202). Construct validity can be achieved through triangulation. Triangulation refers to the analysis of at least three different sources of data, which can be cross-checked, using varying methods. “The aim of the triangulated approach is to draw on the particular and different strengths of various data collection methods” (Pettigrew, 1990, p. 277). In addition, the longitudinal character of the investigation should also strengthen the validity of the theory.



Although the findings of this research do not rely upon interviews, interviews nevertheless play a role in corroborating certain arguments and cross-

checking specific information and developments. The subordinated role of interviews results from the decision to analyse the realised corporate strategies of publicly listed banks as opposed to emerging business strategies of non-listed institutions. Interviews with current and former board members and other leading bank managers were formal and structured. Informal and semi-structured interviews were carried out with a large number of people within the context of the author's job.

As this research combines three different methods, other than interviews, the institutional memory issue is not a major problem for this research. The absence of an institutional memory is a particular challenge for longitudinal research that needs to heavily rely on interviews as the prime source of information. In a BIS working paper, Berger and Udell address the issue of institutional memory in the case of bank management with respect to the banks' lending policies (Berger & Udell, 2003). They find evidence that a weak institutional memory contributes to banks' loan procyclicality.⁴ Berger and Udell do not simply demonstrate that there is an institutional memory problem with banks, but also show that this has even a negative effect on a bank's operations. One way to overcome the institutional memory problem from a researcher's point of view is triangulation, by combining a qualitative database survey, archival research and a quantitative accounting analysis. In the following section, the three different methods of triangulation are presented in detail.

⁴ They argue that "institutional memory problems may drive a pattern of business lending that is associated with a deterioration in the ability of a bank to recognise potential loan problems and an easing of credit standards over its own loan cycle. Specifically, lending institutions may tend to forget the lessons they learned from their problem loans as time passes since their last loan "bust"" (Berger & Udell, 2003, p. 1).

4.5.1. Accounting analysis

For the analysis of realised strategies, three different sets of data from three different sources are used. The first data for the quantitative analysis of the banks' strategic management are from Bankscope, a database owned by Bureau van Dijk. Bankscope contains information on 11,000 public and private banks, which integrates the highly regarded Fitch Ratings (Fitch-IBCA) database. The system provides standardised data formats, which facilitates peer group analysis. Bankscope provides a detailed breakdown of the banks' balance sheets, income statements and key ratios. The analysis of a bank's balance sheets and income statements makes it possible to identify structural changes which reflect its realised strategy.

Montanaro et al. (2001) point out that an international comparison of banking data requires a cautionary note. Differences in fiscal regimes, particularly the fiscal treatment of financial instruments, accounting rules, reserve requirements and inflation rates, do not make banks' balance sheets and income statements fully comparable (Montanaro et al., 2001, p. 124). Valid as these objections are, they are the premises on which any international comparative study rests and have to be accepted in such research projects. It could even be argued that these differences render a comparison of banks in the context of increasing integration of the European financial systems particularly interesting.

Moreover, there is little a researcher can do about creative or even fraudulent accounting. The data used by Bankscope originates from Fitch Ratings (Fitch-IBCA) and the audited annual accounts of the banks. The remaining uncertainty about the accuracy of the audited results and the aforementioned difficulty that there is room for interpretation in accounting methods strengthen the case for triangulation and a combination of quantitative and qualitative methods. In order to minimise the risk of flawed data and to deal with the changeover to different accounting standards, this research primarily considers relative intra-period data.

The longitudinal nature of this study also facilitates consistency tests. If ratios are not consistent over time, then qualitative data may explain these shifts. One friction that had to be taken into account results from accounting

changeovers. The impact of these changes is considered in each case when they occurred. Despite these cautionary remarks, the reliability of audited accounts has to be accepted⁵ as a premise of this research.

The quantitative accounting analysis is broken down into four different sections. The analysis starts with the bank's income components, followed by a section on cost and risk management. The third section discusses the bank's asset-liability structure, while the final section considers overall profitability. This order also serves as the structure for the case studies. Consequently, the chapter containing the case studies is divided into nine sections, one for each bank, preceded by an introduction about the British and German banking landscape. All sections are structured the same way, which facilitates comparison of the findings.

⁵ The pragmatic limits to scepticism need to be recognised. If, for example, the annual reports of any of these banks were incorrect in 1993, even the banks' accountants and auditors could do very little about it today.

4.5.1.1. Income structure

The changing structure of a bank's earnings composition is subject of the first part of each case study, after the introduction, which assesses the bank's status quo in 1993. The analysis of each bank's income structure concentrates on the relative significance of the different components of operating income. A bank's operating income consists of interest income, commission income, trading income and an item comprising various other income, which could be insurance premiums, if it also operates an insurance arm. Regarding these four sources of income, this research always refers to net figures, i.e. after the respective expenses, unless otherwise specified.

For example, in the case of interest income, a bank that is active in the lending business receives interest income on its loans. These loans are shown as assets on the bank's balance sheet. The bank finances these loans largely through deposits and a broad range of capital market instruments, such as bonds, for which it has to pay interest. Therefore, deposits, loans and other sources of funding can be found on the liabilities side of the bank's balance sheet. The difference between a bank's interest income and interest expenses is net interest income, which contributes to its total operating income.

Studying the income structure of each bank over a decade could reveal, for example, a shift from net interest income to commission income. Behind this changed earnings structure lies an increase in the proportion of transaction services relative to transformation activities. This could result from the general trend towards disintermediation or from the bank's growing investment banking operations.

Additional aspects considered in the section on the income structure are the banks' geographical breakdown of revenues, the development of absolute operating income versus non-operating income and the bank's net interest margin. Net interest margin refers to the return on average earning assets, calculated by dividing net interest income by average earning assets (Golin, 2001, p. 703).

This general overview of income structure is followed by a detailed analysis of three core segments, Corporate and Investment Banking, Asset Management, and Retail Banking. It is argued that all eight banks researched were active in

one way or another in these three business fields, whereby retail banking also subsumes their private banking and insurance activities.

4.5.1.2. Cost and risk management

A second set of ratios, elaborated in section three of each case study, aims to shed light on the bank's cost and risk management. This is done through an analysis of loan loss provisions, the cost income ratio, the NPL coverage ratio (non-performing loans coverage ratio) and a comparison of revenues and costs per employee. In the sections on cost and risk management, credit risk is considered the main risk factor. A survey of risk management showed that more than 50% of banks view credit risk as their greatest risk (The Boston Consulting Group, 2000). Market risks are only indirectly considered in the analysis of the banks' trading results. Operating risks are at the heart of each case study as corporate strategic management comprises by nature operational risk management.

While the development of the bank's loan loss provisions says much about risk management as well as its pricing power in the lending market, the cost income ratio provides insights into operational efficiency. The volatility of loan loss provisions is also considered an important indicator of the quality of risk management. This is because a bank's management is expected to correctly assess the risks of its loan book and should be able to control the level of loan losses over several years within a narrow range. Substantial over and under-provisioning causes net profits to fluctuate considerably. This, in turn, could lead to rising cost of equity assumptions. Moreover, highly volatile risk provisions raise the question of whether management really understands the risks on its loan book.

The changes in and level of a bank's NPL coverage offer supplementary information about its risk management skills. NPL coverage, which is mainly used by credit analysts, shows loan loss reserves relative to impaired loans (gross) and is therefore part of the Bankscope/Fitch database. The NPL coverage indicates the degree to which problem loans are covered by loan loss reserves (Golin, 2001, p. 637). According to Golin, if the ratio exceeds 100% coverage is "ample", 75-100% is "good", 50-75% is "fair", less than 50% is "problematic" and below 25% is "weak" (Golin, 2001, p. 637).

Personnel expenses per employee and revenues per employee show, for example, whether reducing staff actually raises efficiency. It often also reflects a decision to enter or exit investment banking, where revenues and costs are

high per employee. These ratios are supplemented by figures about general growth in the number of employees, an analysis of management's cost-cutting measures and a review of lending strategies. A final aspect that is examined in the context of risk management is the bank's goodwill exposure.

4.5.1.3. Asset-liability structure

This section studies the asset and liability structure of the banks under review. The analysis of asset structure concentrates on the split of loans, deposits held at other banks (interbank market), non-earning assets such as goodwill, fixed assets and other earning assets. Other earning assets are often related to trading assets. Moreover, case-specific issues relating to the bank's loan portfolio are discussed in this part of the case study. These range from diversification issues to the securitisation of loans.

Besides the asset and loan portfolio structure, the actual balance sheet growth is elaborated and serves as the analytical linkage between the asset and liabilities side of a bank's balance sheet. Financial regulators require that a bank's loan portfolio must be backed by shareholders' equity. A bank's tier 1 ratio expresses the relative size of its risk-weighted assets and tier 1 capital which is roughly the equivalent to shareholders' equity according the 1988 Basel Accord.⁶

Regulatory requirements specify that to be well capitalised a bank's tier 1 ratio has to be at least 4%. Consequently, a bank with a strong capital base should find it easy to expand its loan portfolio, thereby maintaining its tier 1 ratio at a level that management deems reasonable. If the tier 1 ratio is too high, the bank should either grow its loan portfolio, or reduce its capital base, either through higher dividend payout ratios, or through share buybacks.

On the liabilities side, the focus is on the relationship of shareholders' equity to outstanding bonds (including hybrids) and deposits (retail). This section also takes into account the bank's capital measures, first and foremost capital increases and share buybacks. Discussing a bank's capitalisation in general and equity base in particular paves the way for the final section in each case study before the conclusion, namely profitability.

⁶ Tier 1 capital is defined as core capital and its constituents are generally the following: paid-up common (ordinary) share capital, perpetual non-cumulative preferred shares, disclosed reserves, minority interest, and current profit/loss but excluding goodwill and intangible assets (Golin, 2001, p. 726).

4.5.1.4. Profitability

The most prominent ratio for measuring bank profitability is the return on equity (ROE). ROE generally refers to the return on average equity, as equity may change during the period in which the return is generated. Although the ROE is an important profitability ratio for all companies as it represents the return for the company's owners, it is of particular significance for banks.

This particular role is due to the aforementioned regulatory capital requirements for banks that provide loans and the possibility of raising ROE by lowering the equity base. Unless otherwise stated, this research focuses on the after-tax return on equity and uses the figures obtained from the Bankscope/Fitch database. Nevertheless, pre-tax profits and the pre-tax ROE are also considered where appropriate.

Overall, the purpose of this section is to gain an understanding of the nature of a bank's profitability. More specifically, it examines which are the driving factors behind the bank's profits or losses. Especially for German banks, it is relevant to look at non-operating income as a means of boosting net profit. Consequently, adjusted pre-tax ROE figures offer a more balanced view of underlying, and thus sustainable, profitability.

Notwithstanding the adjustments for non-operating income from disposal gains, this research avoids making too many adjustments. For example, a particularly low tax rate would not be adjusted, but accepted as clever tax management and considered as a strategic achievement. Similarly, this section does not refer to the valuation of the banks analysed, i.e. the development of their value during the period analysed. However, for information, a chart showing the relative share price performance of all eight banks is included in chapter six.

4.5.2. Archival research

The second approach to studying banks' strategic management is based on archival research. Essentially this comprises a survey of the banks' own publications, such as annual reports, presentations, press releases and, where available internal memos. This is the least structured method as it is dependent on randomly available information. Access to these materials was gained through the banks themselves and through libraries, research institutions and central banks.

Jimerson describes archival material as an attempt to codify memory (Jimerson, 2003). He argues that the human need for impartial evidence of interactions, from legal agreements to financial transactions has led to the concept of archives as repositories of memory (Jimerson, 2003, p. 90). It is argued that archival data is a by-product of human activity and that such records provide a reliable and authentic source (Jenkinson, 1922; Duranti, 1994). Archival documents result from activity itself, and are not conscious or deliberate efforts to influence thought (Jimerson, 2003, p. 90).

This positivist understanding of archival material is challenged by post-modernist writers (Brothman, 1991; Nesmith, 1999; Kaplan, 2000; Cook, 2001), who argue that the choice of which developments are recorded and how they are recorded is determined by individuals and organisations with vested interests (Kaplan, 2000). Kaplan rightly concludes that archival material is thus certainly not politically and culturally neutral (Kaplan, 2000).

Insofar, this research acknowledges the reservations of the post-modernist critiques. Yet, it should also be borne in mind that the pursuit of clearly identified interests is what strategy is all about. Despite prudent reporting practices, it is assumed that any official information published by the banks would attempt to sketch a positive picture of their strategy. Therefore, archival material used for this research is not considered to offer an "objective" account of what happened; it is understood as part of a bank's communication policy and as such as part of its strategy.

Although most banks employ their own historians and archivists, who can help in finding the relevant information, it has proven difficult to gather information

about the years before 1997/1998. Even publicly available information could not be as easily accessed as had been initially expected. For example, most banks only archive a few reference copies of their annual reports. Besides, there are not many presentations left from the first half of the period analysed. Overall, it required interpersonal skills to encourage staff to copy the relevant material and send it to the researcher. The researcher's profession as an equity analyst also undoubtedly helped him approach the right people within the institutions. The difficulty of gaining access to this material is in accordance with the aforementioned institutional memory problem of banks. For the period after 1998, the internet has proven a helpful archival source.

4.5.3. LexisNexis database survey

The main qualitative source used is the LexisNexis database. This has proven useful in previous research projects on the temporal development of strategies, for example in the British insurance industry (Pettigrew & Webb, 1999). The LexisNexis database provides news and business articles from major international newspapers, journals and periodicals dating back beyond 1993. In total, it comprises 32,000 sources, including such quality publications as *The Economist*, *Businessweek*, *The Banker*, *Financial Times*, *The Times*, *The Guardian*, *The Independent*, *Wall Street Journal* (abstracts), *Bloomberg News*, *Börsen-Zeitung*, *Frankfurter Allgemeine Zeitung*, *Süddeutsche Zeitung*, *Capital* and *Der Spiegel*.

A three-stage search modus is applied. The first approach searches the aforementioned sources. Articles are extracted using the bank's name as the search term for the period analysed (1 January 1993 until 31 December 2003). Following this automatic search, in a second step the available data is downloaded, scanned, read and analysed. After having identified developments that appear to have had structural implications for the bank, the third stage extracts data using more narrowly defined search terms for a shorter period while broadening the number of sources to the whole of the LexisNexis database. Finally, the data is interpreted, classified and entered into a time/event matrix.

Denscombe (2003) considers that good quality news media, such as *The Economist* and the *Financial Times* are a valuable source of information for business researchers, allowing them to draw on the expertise of specialised journalists. A comparison of several of these newspapers is conducive to receiving a more complete picture. Moreover, any action taken by a bank's top management that had structural implications was probed at the time by numerous journalists using different information sources. Articles published in these quality newspapers and journals are usually reviewed thoroughly, questioned and edited before they go to print. Given the politically sensitive nature of the banking industry, financial journalists who write on the sector tend to pay particular attention to detail. Nevertheless, the researcher needs to distinguish carefully between journalists' interpretations and the presentation of facts.

4.6. A note on the author's background and concluding remarks

Peter Reason's concept of "critical subjectivity" suggests that it is essential to elaborate the context and the background of the researcher (Reason, 1988). Therefore, it should be pointed out that the researcher has professionally analysed European financial services firms in his capacity as an equity analyst since 2000. During the period of this dissertation, the author was employed by a family-owned German investment bank. Prior to this, he had worked in the City of London for an independent corporate finance advisory firm and for a privately owned British merchant bank.

With the exception of Dresdner Bank, after it had been taken over by Allianz, the author has not covered any of the eight banks analysed in his capacity as an equity analyst. The author has not received any direct or indirect compensation for this research. All expenses related to this research were financed from his own personal savings. Neither any of the analysed banks, nor his employer nor the School of Management of the University of Bath have influenced or tried to influence the research approach, the samples or the methodology.

Although this research is free from any conflict of interest, it nevertheless reflects the author's professional background in two ways. First, Britain and Germany are chosen not only because they are two of Europe's largest economies with different financial and banking systems, but admittedly also because of the author's academic and professional background. Despite this personal bias, it can be still maintained that the size of the economies and the contrasting developments of banking in both countries render a comparison of banks from these two countries a viable choice.

Second, in accordance with the view propounded by Strauss (Strauss, 1987; Strauss & Corbin, 1994), the researcher concedes that preconceptions about strategic management in banking exist in his mind as a result of his professional exposure to that industry. Yet, this is still consistent with the Straussian understanding of grounded theory (Strauss, 1987; Strauss &

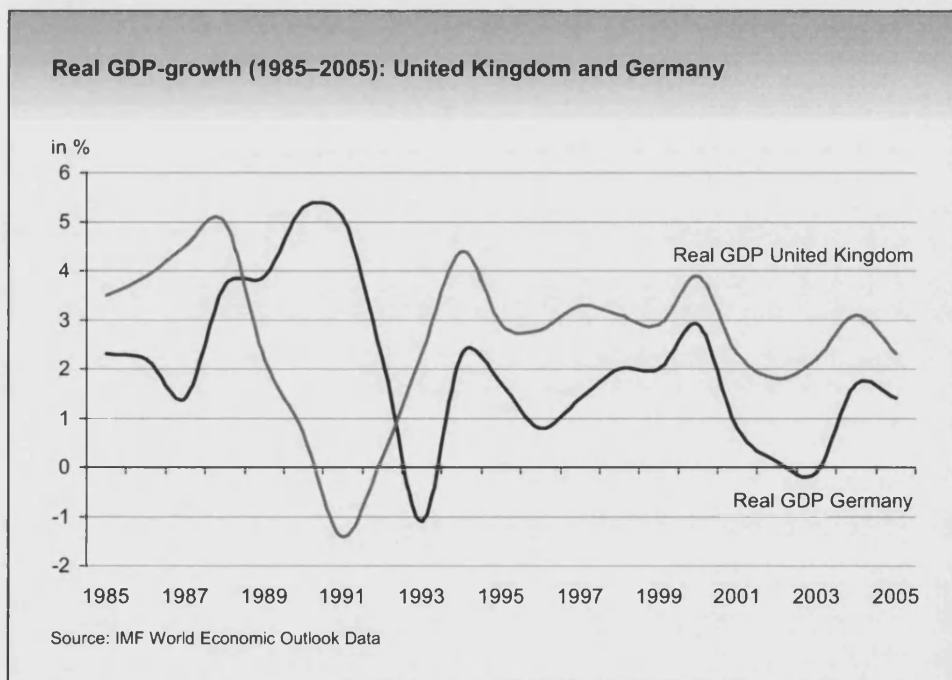
Corbin, 1994) as any research project requires some basic understanding of or interest in the subject.

This chapter outlined and justified the methodology and methods of this research. Drawing on an ontology that comprehends the micro level to be interdependent with the macro level, this thesis applies an inductive methodology. The combination of qualitative and quantitative methods applied to data from three different sources aims to generate knowledge about strategic management in banking. Starting from a longitudinal comparative case study of British and German banking strategies, the objective is to build a theory about the corporate strategic decisions taken by banks in a changing macroeconomic and political environment. More specifically, it seeks to understand how and why, in the period analysed, British and German banking strategies differed in an increasingly integrated European financial system.

5. British and German banking: case studies

5.1. Introduction

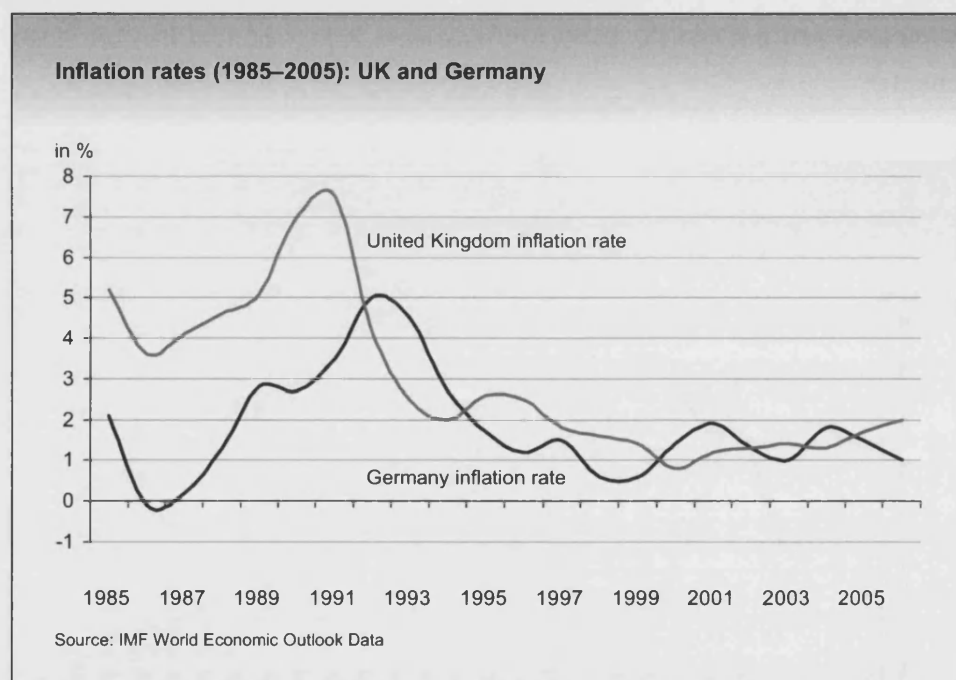
While this research argues that the Single Market opened up new prospects for banks to operate within an enlarged “playing field”, it also recognises that national financial systems remained the predominant operating environment for banks. Following a brief review of the characteristics of the banking landscape in the UK and Germany, this chapter presents eight case studies on British and German banks. British and German banks are discussed in alternating order, beginning with the success story of The Royal Bank of Scotland, and ending with the dismal tale of Dresdner Bank. The case studies form the heart of this empirical research and the findings are cross-analysed, compared and put into the context of European integration in the concluding chapter.



At the beginning of the 1990s, the home markets in which British and German banks operated had entirely different structures. The economic and political situations in those two countries differed significantly at the time. British economic growth fell sharply in the late 1980s and the country plunged into

recession in 1991. During this period, most British banks suffered from high loan loss provisions and profits were severely battered as a result of this.

In contrast, German reunification in October 1990, the end of communism and the first signs of globalisation brought about a sense in Germany that a new era was beginning. These circumstances, helped by substantial government spending, boosted Germany's economic growth to 5.3% in 1990, the highest rate achieved between 1985 and 2005. Yet, in the next three years German GDP growth decelerated and in 1993 the country was also hit by recession. After the recession in Britain and Germany, their business cycles converged in shape and pattern. Notwithstanding this structural convergence, British GDP growth rates were on average 1.7% higher than German rates between 1993 and 2003.



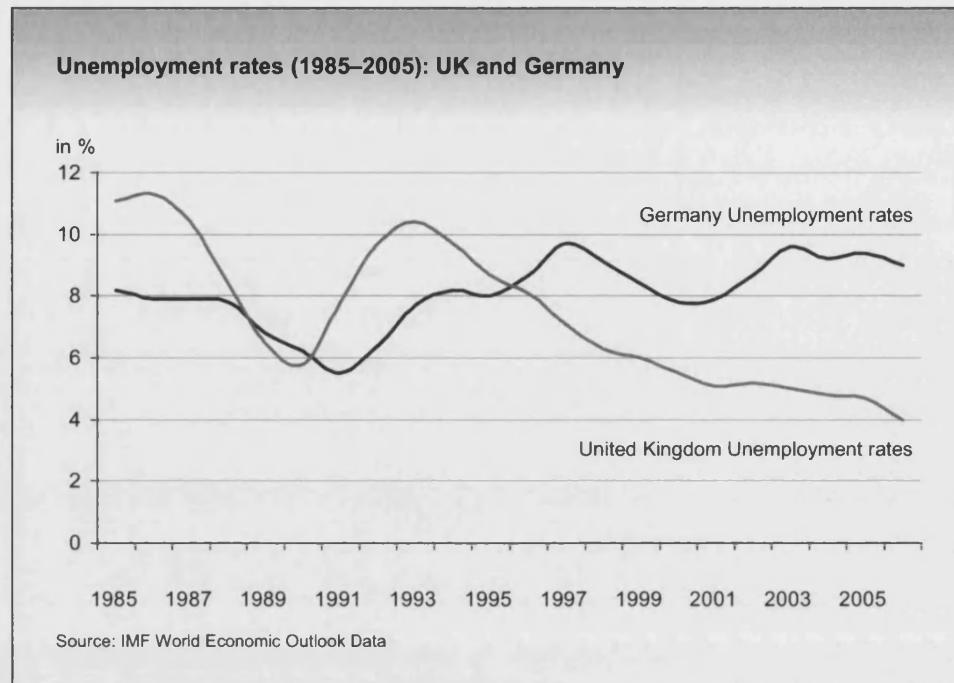
This markedly higher economic growth rate provided an important tailwind for British banks as they continued to focus their business models on the UK market while reining in costs through branch closures and greater use of new technologies. The positive economic climate in the UK was also reflected in a decline in British unemployment rates. Moreover, British inflation rates fell sharply in the early 1990s and became much more stable. Certainly, the decision to make the Bank of England independent from the Treasury as from

1997, was instrumental in the establishment of a monetary policy that was committed to meeting an inflation target of 2.5% (now 2%).

Declining unemployment, low and stable inflation rates, along with the strong economic growth stimulated consumer spending, and led to rising property prices and fewer bankruptcies. All of these developments contributed to an increase in profits of most UK banks. During the period analysed, the macroeconomic environment in Britain was clearly much more benign for banks than the situation in Germany.

The impact of German reunification was essentially an exogenous shock for the country's economy. Initial enthusiasm about the prospect of an enlarged German market was quickly overshadowed by the realisation that the costs would outweigh the benefits in the short term. German banks were instrumental in the rapid transformation of East Germany's planned economy into a market economy. German monetary union on 1 July 1990 meant that all banks operating in East Germany came within the remit of the Bundesbank's monetary policy and thus became an integral part of its monetary transmission function.

All four German banks analysed for this research rapidly expanded into Eastern Germany and, along with the savings and cooperative banks, divided up the market among themselves. "Since 1990 the attention of the major commercial banks has been deflected towards German unification" (Henderson, 1993, p. 189). Demand for loans clearly exceeded the amount of deposits in Eastern Germany during the first years after reunification. Thus, inevitably an asset-liability mismatch arose, mirroring the significantly different economic levels of Eastern and Western Germany. Besides providing funds for investments in the five new federal states, Western German banks played an important role as educators of the 16 million inhabitants of Eastern Germany who had to come to terms with the changeover from a state planned economy to a market economy (Birkefeld, 1997).



In addition to this economic and political turbulence, for which none of the German banks could prepare, it is often pointed out that the German banking market suffers from distorting competitive forces. One characteristic of the German banking market is the dominant position of what have been termed “not strictly profit-oriented” banks (Hackethal & Schmidt, 2005), i.e. cooperative and savings banks. Cooperative banks, savings banks and commercial banks, i.e. private-sector institutions such as the four German banks analysed for this research, are usually referred to as the three pillars of German banking.

Cooperative banks have their roots in a self-aid effort initiated by German craftsmen and farmers in the 19th century (Butt Philip, 1978). As mutual organisations, cooperative banks are owned by their members, who are usually also clients. At the beginning of 1993, the cooperative banking sector comprised 2,918 local cooperative banks (Volksbanken and Raiffeisenbanken), five regional central clearing institutions, and a central body, the Deutsche Genossenschaftsbank, Germany’s seventh largest bank (Henderson, 1993). A large number of mergers in this sector during the 1990s brought down the number substantially. At the end of 2003, the number of cooperative banks had fallen to 1,393, owned by 15 million members (Hackethal & Schmidt, 2005).

By end-2003, only two central clearing institutions remained: the WGZ Bank and the DZ Bank (Hackethal & Schmidt, 2005). These offer a broad range of services to the primary credit cooperative banks. Besides acting as clearing institutions, they provide access to the financial markets and a wide array of other support and back-office functions (Hackethal & Schmidt, 2005). With a large number of retail clients and two central institutions providing a full range of capital market services, the cooperative banking group is a universal bank that competes in many areas with the commercial banks. It enjoys a relative competitive advantage as it can draw on a large retail client base for funding. The small size of the primary institutions (i.e. local branches) is also considered a competitive advantage as it facilitates quick decision-making and proximity to clients (Hackethal & Schmidt, 2005).

Like the cooperative banking group the savings bank group also has a two-level structure: the local retail savings banks and the regional wholesale and girobanks, the so-called Landesbanks. Savings banks came into existence in the 18th century as a result of private initiatives driven by philanthropic considerations and the need to fight poverty (Mura, ed., 1996). Their purpose was to finance regional infrastructure projects and make loans to disadvantaged groups in the community, financed by small deposits made by households and local companies (Howells & Bain, 2002). Over the years, they have remained focused on the needs of employees, small and medium-sized enterprises and certain public authorities (Hackethal & Schmidt, 2005).

While there are many structural and organisational similarities between cooperative and savings banks (Henderson, 1993; Edwards & Fischer, 1994; Hackethal & Schmidt, 2005), the savings banks' greatest competitive advantage came from state guarantees.¹ In return for their public-spirited lending policy, the solvency of each savings bank was guaranteed by the public authority that owned them until 18 July 2005, when an EU ruling from July 2001 became effective. These state guarantees enabled them to obtain better refinancing conditions on the capital market. It is estimated that state backing helped savings banks and Landesbanks pay around 20 basis points

¹ More specifically, the guarantees comprise two aspects "Anstaltslast" and "Gewährträgerhaftung". Anstaltslast is a term used in German public law, meaning that the public sector is responsible for the viability of companies it owns. Gewährträgerhaftung refers to the liability that would take effect if and when a

(0.20%) less than their private-sector peers when raising funds through bond issues. The EU Commission assumed the benefit to be even higher - in the range of 25 to 50 basis points (0.25-0.50%) (Hackethal & Schmidt, 2005).

Abolishing state guarantees has probably increased competition in German banking, but has not changed ownership structures. Savings banks are still public-sector institutions and the state remains the largest provider of banking services to retail and SME clients in Germany. State ownership limits the scope for savings banks to raise fresh equity as municipalities are rarely in a position to inject additional equity. Thus, savings banks have to be profitable in order to grow their lending business, although profit maximisation is neither their only, nor their primary business objective (Hackethal & Schmidt, 2005).

At the start of the Single European Market, 36% of the combined balance sheet of the entire German banking sector was in the hands of the savings banks and Landesbanks. With 320,000 people employed in more than 20,000 branches of 723 legally separate savings banks, this banking group constituted the largest part of the German banking sector at the end of 1992 (Mura, ed., 1996). The number of savings banks dropped to 491 at the end of 2003, largely due to mergers and acquisitions within the group. Despite the fall in the number of savings banks, the German savings bank group as a whole was the world's largest financial institution at the end of 2003 with assets of EUR 3,300 billion and 393,000 employees (Hackethal & Schmidt, 2005).

Across all three pillars there were in total 4,038 banks in Germany in 1993. During the decade that followed this fell to 2,465, a decline of 39%. At the same time, the total number of bank branches was cut by 31% from 53,156 (1993) to 36,599 (2003).² In 1993 the number of banks in Germany was 50 per million inhabitants, compared to 9 per million in the UK. The respective figures for branches were 655 per million inhabitants in Germany and 222 per million in the UK, suggesting a less competitive environment in the UK banking market at the beginning of the Common Market.

savings bank's or Landesbank's debts exceeded its assets and the creditors' claims could therefore not be satisfied even after liquidation of its assets (Deutscher Sparkassen- und Giroverband, 2000).

² This is without the German post offices as part of Postbank AG.

Although capacity in Germany was reduced substantially between 1993 and 2003, bank and branch density was still high compared to the UK at the end of the period analysed. Overall, on a per capita basis there were more than twice as many bank branches and five times as many banks in Germany as in Britain in 2003. More specifically, there were 30 banks and 444 branches per million inhabitants in Germany. The density was significantly lower in the UK, with 6 banks and 196 branches per million inhabitants.

The difference in bank and branch density is also mirrored in the higher number of people working in banking in Germany, regardless of London's strong position as a financial centre. However, it is striking that during the decade analysed the UK gained 54,000 new employees in banking and Germany shed 51,000 jobs in this sector. Notwithstanding this shift, in 2003 there were still 722,000 people working for banks in Germany compared to 432,800 in the UK.

The much more fragmented German banking market is a reflection of the prevailing three-pillar structure. Even in a European context, concentration is low in the German banking sector. A report by Deutsche Bank remarked in 2004 that the market share of the country's five largest banks was just 20%, only half the European average of 39% (Deutsche Bank Research, 2004).

The three-pillar structure is certainly the pre-eminent characteristic of the German banking sector as it means that around half of the country's banks are not strictly profit-oriented. This raises the question of the extent to which German banking is embedded in a stakeholder value-oriented system, making it difficult to achieve returns on equity close to those of banks operating in a shareholder value-oriented system. This research contests the argument that a model which distinguishes primarily between shareholder value-oriented financial systems and stakeholder value systems can sufficiently explain the different levels of profitability of banks (Llewellyn, 2005).

In addition to the prominent role played by banks that are not strictly profit-oriented, German banking has been influenced by a business model described as "universal banking". A universal bank provides a broad range of banking and other services "that elsewhere would be called financial rather than banking services" (Howells & Bain, 2002, p. 113). Universal banks offer

retail, wholesale and investment banking services. Of the roughly 2,500 German banks that existed at the end of 2003, 90% were categorised by BaFin as universal banks (Hackethal & Schmidt, 2005).

The savings bank group, including the Landesbanks, and the cooperative bank group offer such a broad range of financial services to retail and wholesale clients that they can undoubtedly be categorised as universal banks. Notwithstanding their universal banking character, both of these groups refrained from overly extensive international lending and capital market related business in the 1990s (Hackethal & Schmidt, 2005). This strategic focus on local retail and SME clients helped ensure that their profitability³ was relatively higher than that of private-sector banks.

The big four German banks analysed for this research are commercial banks, which have had universal banking features since their inception (Howells & Bain, 2002). These big four banks, which originate from the beginnings of the unified German state in the 1870s, have offered retail banking services from an early stage, although their business has been traditionally concentrated on the financing of firms and international trade. Retail banking was initially only developed as a cheap source of funding for their corporate lending activities.

The commercial banks' direct involvement in the rise of German industry created close relationships between the banks and their corporate clients. This form of relationship banking was intensified by a shortage of venture capital. Subsequently, the big commercial banks became active investors in those companies to which they lent money, with a seat on the companies' supervisory boards to represent their interests (Butt Philip, 1978). The bank's presence on the supervisory boards normally predisposed companies to use that bank as their main bank (Butt Philip, 1978). The intricate relationship between Germany's commercial banks and their clients is referred to as the housebank principle (Hausbanken-Prinzip). Effectively, the banks' combined equity and debt financing approach also served the purpose of overcoming the principal-agent problem and was thus a means of risk monitoring.

³ Between 1993 and 2002 the average return on equity of commercial ("private-sector") banks was 2.7 percentage points lower than that of the public-sector and cooperative banks (Weber, 2003).

The housebank relationships are symptomatic of the bank-dominated financial system found in Germany for most of the twentieth century. As disintermediation gained significance and international competition increased, these traditional relationships declined and lost their binding force. This process was accelerated by the fact that some of the large commercial banks had to make substantial impairment write-downs on equity investments. In fact, the German financial system became slightly less bank-dominated throughout the 1990s. Nevertheless, banks remained important financial intermediaries for the German industry until the turn of the century (Schmidt, 2001).

And yet, disintermediation from retail clients gained such magnitude in Germany that at the end of 2003 only about one quarter of new savings were deposited with banks. By contrast, in the early 1980s around two-thirds of private households' monetary wealth was still held in the form of bank deposits (Bundesverband Deutscher Banken, 2004). As observed by the Association of German Banks, (Bundesverband Deutscher Banken) which represents the interests of commercial banks, the relative decline in low-cost deposits from private households required banks to turn to the more expensive money and capital markets for refinancing purposes, thus reducing their net interest margins (Bundesverband Deutscher Banken, 2004).

The Association of German Banks concedes that most financial institutions have been slow to react to the disintermediation trend and that banks in other European countries delivered much higher and faster growing profits than German banks, despite working under similar overall economic conditions (Bundesverband Deutscher Banken, 2004). It concludes that non-German European banks were "more successful in adapting to changed market conditions and have better exploited their earnings potential" (Bundesverband Deutscher Banken, 2004, p. 11).

The Association of German Banks therefore maintains that the reasons for the poor profitability of German banks must be country-specific. It argues that the distorted competitive structure and state guarantees are responsible for this plight. In its analysis, the Association of German Banks does not consider that bad risk-management tools, lack of service orientation, inadequate sales skills

and simply poor management could have been the decisive factors in this development.

In its Financial System Stability Assessment of Germany⁴ in 2003, the International Monetary Fund (IMF) puts forward arguments similar to those used by the Association of German Banks: “A reduction in existing legal and other barriers to restructuring, within or across pillars, would expand the scope of possible market-oriented solutions” (International Monetary Fund, 2003b, pp. 4-5).

The IMF report also takes the view that, although “the institutional protection schemes in the public and cooperative pillars have provided an important element of stability”, changes that would facilitate the exit of banks and the reduction of excess capacity should be introduced in Germany, in order to better handle any possible systemic problems (International Monetary Fund, 2003b, p. 5).

However, for legal and political reasons, the three-pillar structure of the German banking system has remained in place. As a result of this structural rigidity, mergers across the three pillars have not taken place. Therefore, commercial banks had less scope for consolidation than, for example, their British counterparts. The scope for consolidation in Britain’s financial services industry increased significantly after the 1986 Building Societies Act.

Building societies in the UK originate from the 18th century. Like the German cooperative banks, British building societies were originally mutual societies with a local focus. However, their focus was much narrower than that of the cooperative banks as members’ payments initially served only to finance the building of houses. The focus on housing construction was so exclusive in the early days that building societies were dissolved once their housebuilding programme was completed (Howells & Bain, 2002).

⁴ The Financial System Stability Assessment report was based on work for the Financial Sector Assessment Program (FSAP) – not to be confused with the same acronym used for the EU’s Financial Services Action Plan (FSAP).

Aggregate data on the British and German banking sector

		1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Number of banks	UK	508	486	481	478	466	468	449	420	409	385	380
	Germany*	4,038	3,872	3,784	3,674	3,577	3,403	3,167	2,911	2,696	2,591	2,465
Number of branches	UK	12,800	12,400	12,000	11,700	13,400	13,000	12,650	12,450	12,280	12,140	11,624
	Germany*	53,156	52,593	52,009	51,416	50,663	48,630	47,610	43,307	41,139	38,201	36,599
Number of employees in banking	UK	378,700	367,700	364,300	357,000	420,300	437,200	447,800	442,100	436,400	435,700	432,800
	Germany*	773,050	779,450	778,250	769,800	768,150	769,350	771,650	774,550	769,300	751,200	722,000
Total assets	UK (in EUR million)	1,926,700	1,989,500	2,085,800	2,497,300	3,659,400	3,687,700	4,216,110	5,112,400	5,508,710	5,921,810	6,785,710
	Germany (in EUR million)	3,370,500	3,554,900	3,854,600	4,239,800	4,657,800	5,157,700	5,740,700	6,148,300	6,386,100	6,452,300	6,470,900
Deposits (from non-banks)	UK (in EUR million)	1,371,600	1,406,200	1,487,900	1,715,600	2,454,400	2,494,200	2,790,110	2,405,220	2,722,580	2,897,820	3,493,210
	Germany (in EUR million)	1,508,800	1,563,100	1,659,400	1,797,200	1,879,400	1,999,500	2,189,700	2,260,700	2,384,600	2,405,100	2,447,600
Loans (from non-banks)	UK (in EUR million)	1,322,500	1,358,000	1,421,100	1,670,600	2,428,500	2,429,700	2,780,060	2,473,740	2,717,740	2,977,160	3,283,330
	Germany (in EUR million)	1,799,800	1,902,800	2,065,500	2,235,900	2,408,800	2,575,600	2,812,400	2,950,500	3,051,400	3,021,700	3,025,500
Deposits / Total assets	UK	71%	71%	71%	69%	67%	68%	66%	47%	49%	49%	51%
	Germany	45%	44%	43%	42%	40%	39%	38%	37%	37%	37%	38%
Loans / Total assets	UK	69%	68%	68%	67%	66%	66%	66%	48%	49%	50%	48%
	Germany	53%	54%	54%	53%	52%	50%	49%	48%	48%	47%	47%
Number of banks per million inhabitants	UK	9	8	8	8	8	8	8	7	7	7	6
	Germany	50	48	46	45	44	41	39	35	33	31	30
Number of branches per million inhabitants	UK	222	214	207	201	230	223	216	212	208	205	196
	Germany	655	646	637	629	618	592	581	527	500	464	444

* Figures for number of banks, branch offices and employees do not include Postbank AG

Sources: British Bankers' Association; Financial Services Authority; Deutsche

Bundesbank; Bundesverband deutscher Banken; European Banking

Federation (FBE); Eurostat

Building societies have always effectively been deposit-taking institutions. The Building Societies Act of 1986 permitted building societies to issue cheque guarantee cards and grant unsecured loans as well. Thus, the formal distinction between banks and building societies was removed (Howells & Bain, 2002). Subsequently building societies could demutualise and become publicly limited banks, subject to a vote of approval by their members. The first building society to demutualise and become a publicly listed bank was Abbey National Building Society in 1989, followed by a wave of demutualisations and subsequent flotation in 1996 and 1997 (Howells & Bain, 2002).

During the 1970s and 1980s, several building societies gained significant market shares in the market for personal deposits. Governmental policies that supported home ownership and the desire to invest in real assets that act as an inflation hedge contributed to the success of building societies (Henderson, 1993). In 1980, building societies accounted for 54% of personal deposits while retail banks accounted for 30%. Depriving retail banks of their personal deposit base prompted them to engage in greater liability management to find alternative sources of funding. Retail banks had to offset the declining deposit base largely through more expensive wholesale deposits and bonds, thus raising funding costs.

In October 1988, Lloyds Bank became the first bank to offer all customers interest-bearing current accounts. Its peers followed suit, putting pressure on net interest margins (Plender, FT, 29 October 1988). While funding costs rose, bringing down margins, competition in lending caused banks to target low-margin mortgage and large corporate business (Henderson, 1993). The repercussions of this improvident growth-driven lending were felt in rising loan loss provisions in the following years.

As retail banks lost ground as personal deposit taking institutions during the 1980s, largely due to increased competition from building societies, their market share fell from 30% in 1980 to 25% in 1990 (Henderson, 1993). As a reaction to the changed competitive landscape, British retail banks entered the mortgage market in the early 1980s. Building societies responded by introducing new types of deposits, cheque book facilities and automated teller machines (ATMs). They also attempted to gain market share in client

segments where they were not strong such as young adults, women and savers in lower socioeconomic groups (Henderson, 1993).

The 1986 Building Societies Act was one of several policy measures introduced in 1986/87 to liberalise the British financial services industry. These fundamental structural changes, along with the opening up of membership of the London Stock Exchange (LSE) to limited liability companies are often referred to as the Big Bang in Britain's financial services industry (Howells & Bain, 2000). The policy package was aimed at bringing about deregulation and stimulating competition in the financial services industry.⁵

At the heart of Big Bang were the 1986 Financial Services Act, the 1987 Banking Act and regulatory changes relating to the LSE, which allowed firms to operate as both brokers and market-makers ("dual capacity"). Prior to Big Bang, brokers were only able to advise clients and deal on their behalf, whereas jobbers did the actual buying and selling of shares (Steffens, 1990; Dictionary of Finance and Banking, 1997).

As a result of Big Bang, various British clearers, i.e. high-street banks, took over brokers and market-makers. For example, Barclays created BZW, Barclays de Zoete Wedd, by merging the brokers de Zoete and Bevan and jobber Wedd Durlacher. During the 1980s, several large British banks branched out into the securities market while internationalising, and granting inadequately priced loans as part of a general expansion policy. They also stepped up lending on the domestic wholesale market, that is, to commercial clients, where they encountered fierce competition from international banks.

The 1980s was a difficult decade for British retail banks. In many ways, British banks underwent the developments that German banks would experience during the 1990s – with the same results, namely accruing high losses. The effects of deregulation starting in 1986/87, the stock market crash in October 1987, international competition on the British wholesale market and eventually the onset of a recession at the end of the 1980s came as quite a shock for the management of some banks, resulting in severe cost cuts. Subsequent restructuring curtailed their international activities and led them to withdraw

⁵ In the UK, the first real phase of deregulation occurred in 1971 with the abolition of credit controls and the interest rate cartel under the Competition and Credit Control Act (Henderson, 1993).

from investment banking and refocus on the domestic market. What followed was the rapid adoption of new technologies accompanied by substantial branch closures in the late 1980s and throughout the 1990s.

The deregulation brought about by Big Bang facilitated a process of consolidation and cost-cutting measures. This mainly took the form of branch closures and the introduction of ATMs. During the period analysed, banking in the UK became increasingly automated, with the number of ATMs rising from 19,100 in 1993 to 46,461 in 2003 (ESRC Society Today).⁶ The greater use of technology was accompanied by a reduction in the number of bank branches in the UK from over 20,000 in 1989 to 11,000 by 2004 (British Banker's Association).⁷

These profound restructuring measures, which streamlined many of the processes in banking, and the scale efficiencies from consolidation in the sector made British banks among the most efficient and profitable financial institutions in the world at the turn of the millennium. In a speech given in November 1999 Howard Davies, chairman of Britain's Financial Services Authority (FSA) argued that the competitive environment for British banks had led to substantial cost reductions which, in combination with the strong economic growth in the UK, were important factors for the high levels of profitability in UK banking in the 1990s. He considered the British banking market to be one of the most competitive markets in the world (Davies, 1999).

Shortly after these upbeat remarks by Howard Davies of the FSA, Don Cruickshank, chairman of the Chancellor's review into competition and UK banking, presented the results of a study.⁸ The Cruickshank Report concluded that the banks in the UK had "unnecessary market power which they have been able to use - particularly over the last four or five years - to earn super normal profits" (Cruickshank, 2000, p. 3). The report held the British government, regulator and banks together responsible for the excessive returns of banks, resulting from not subjecting the sector to "proper

⁶ Available from:

<http://www.esrcsocietytoday.ac.uk/ESRCInfoCentre/facts/UK/index44.aspx?ComponentId=12646&SourcePageId=18129#footnote>. [Accessed 19 May 2007].

⁷ British Banker's Association. Available from: <http://www.jmlsg.org.uk/bba/jsp/polopoly.jsp?d=469&a=5524> [Accessed 19 May 2007].

⁸ Don Cruickshank studied the UK banking markets and not the banks as institutions. Thus, the banks' international and non-banking activities were not a subject of the analysis. The cycle considered was from 1986 to 1998 and market concentration was measured using the Herfindhal Hirsch Index.

competition scrutiny and letting banks too often write the rules" (Cruickshank, 2000, p. 4).

The Cruickshank Report argued that a pre-tax return on equity of 30% over the cycle is in excess of the cost of equity (assumed to be 17%) and concluded that this meant high prices for consumers (Cruickshank, 2000, p. 4). The report estimated that consumers would pay some GBP 3-5 billion p.a. less if there were more effective competition in British banking. Furthermore, the Cruickshank Report pointed out that "[...] there are real problems with the way banks control the networks which allow money to flow around the economy [...] and there are real problems with the way banks serve small businesses" (Review of Banking Services in the UK, 2000). This led to a discussion of social exclusion as some three million people in the UK were without access to banking services (Review of Banking Services in the UK, 2000).

Criticism of competition in UK banking did not lead to any pathbreaking regulatory changes and the banks have continued to ride the wave of Britain's sound economy, rising property prices and brisk consumer spending. In 2003 the IMF's Financial System Stability Assessment of the UK concluded that the country's "large and sophisticated financial sector features fundamentally sound and highly developed financial institutions, markets and infrastructure" (International Monetary Fund, 2003a). The IMF report considered that the largest domestic risk for UK banks stemmed from high household and corporate debt levels, which are particular sensitive to a deterioration of domestic economic conditions (International Monetary Fund, 2003a).

The markedly different structural and economic developments in the UK and Germany must be given sufficient consideration when reading the following analysis of four British and four German banks. Each of the eight analyses that follow can be considered as a stand-alone case study and yet they share the same structure, research approach and largely draw on the same database. The findings from the case studies are cross-analysed, compared and put into the context of European integration in the last chapter of this thesis.

5.2. The Royal Bank of Scotland plc

5.2.1. Introduction and Status Quo in 1993

Without the failure of Scotland's overseas trading company, the Company of Scotland Trading to Africa and the Indies ("Company of Scotland"), The Royal Bank of Scotland ("RBS") probably would not have come into existence. As part of the 1707 Acts of Union, which united England and Scotland, investors in the Company of Scotland received compensation, which became the initial capital for The Royal Bank of Scotland. In 1727 the bank was formed by Royal Charter from the British government (Checkland, 1975; Savile, 1996; Royal Bank of Scotland, 1998; Munn, undated).

The foundation of The Royal Bank of Scotland ended the monopoly of the Bank of Scotland which had been set up in 1695 to promote Scottish trade and commerce.¹ Right from the beginning, The Royal Bank of Scotland pursued an aggressive strategy towards the Bank of Scotland. RBS built up large holdings of Bank of Scotland notes, which it then presented to the Bank of Scotland for payment in 1728. Subsequently, the Bank of Scotland had to call in its loans. The fierce competition between the two banks continued until around 1740 when they agreed a kind of truce from which both parties would benefit during the following 260 years (Checkland, 1975; Savile, 1996; Royal Bank of Scotland, 1998). In 1999/2000 open competition broke out again during the battle over NatWest, which the Bank of Scotland had initially intended to take over, but which was eventually acquired by RBS (The Economist, 5 February 2000; Treanor, The Guardian, 10 February 2000; The Economist, 12 February 2000).

The Royal Bank of Scotland realised from its inception that innovation is a means to fight competition. It was the first bank in the world to offer a "cash credit" or "overdraught" in 1728. This "overdraught" facility was effectively the forerunner of modern consumer credit, which became one of RBS' key areas of expertise and main sources of income in the 1990s when it began to refocus on retail banking. During the 18th and 19th centuries the bank expanded its operations throughout Scotland, but hardly beyond the Scottish

border. It did not even have an office in London until 1874, and certainly did not seek to expand overseas. During the 1920s it acquired various small English banks (Checkland, 1975; Savile, 1996; Royal Bank of Scotland, 1998).² The bank's first major international move came with the USD 440 million acquisition of the US retail and corporate bank Citizens Financial Group ("Citizens") in 1988 (Thomson, *The Times*, 29 April 1988).

In the same year The Royal Bank of Scotland linked up with Banco Santander, Spain's fourth largest bank at the time. Both banks agreed to build up cross-shareholdings of 2.5%.³ Moreover, cross-directorships would support this wide-ranging commercial cooperation. This cooperation agreement was meant to help RBS break into continental European markets where it had few business activities. The two banks also agreed to look for joint acquisitions on the European continent (Thomson, *The Times*, 4 October 1988).⁴ Despite this cooperation, RBS conceded in 1993 that the purpose of its presence on the European continent was merely to serve its UK banking customer base. Management then clearly considered the UK as its core market and regarded the US activities solely as a means of diversifying earnings (RBS, Annual Report 1993).

During the period analysed three board members shaped the development of The Royal Bank of Scotland. George Mathewson was appointed to the board in 1987 and served as the bank's group Chief Executive from 1992 to 2000. George Mathewson's successor as group Chief Executive was Fred Goodwin, who has held that position since then. In March 2000, George Mathewson was appointed Executive Deputy Chairman. He subsequently succeeded George Younger (Viscount Younger of Leckie) as group Chairman. In this function, Younger had presided over The Royal Bank of Scotland from 1991 until 2001. The rise of The Royal Bank of Scotland from a provincial Scottish bank in the early 1990s to one of the world's ten largest banks by the end of 2003 owes much to the pathbreaking takeover of the much larger NatWest in 2000, which was jointly masterminded by George Mathewson and Fred Goodwin. In

¹ The Bank of Scotland supported the Jacobites, who wanted to restore the Stuart kings to the thrones of England and Scotland. Following the Jacobite Rising of 1715, the bank's monopoly was terminated in 1716.

² The various small English banks formed Williams Deacons Bank, which later merged with Glyn Mills & Co. and was renamed Williams and Glyn's Bank (Royal Bank of Scotland, 1998).

³ In the following years, Santander raised its stake to 9.9%.

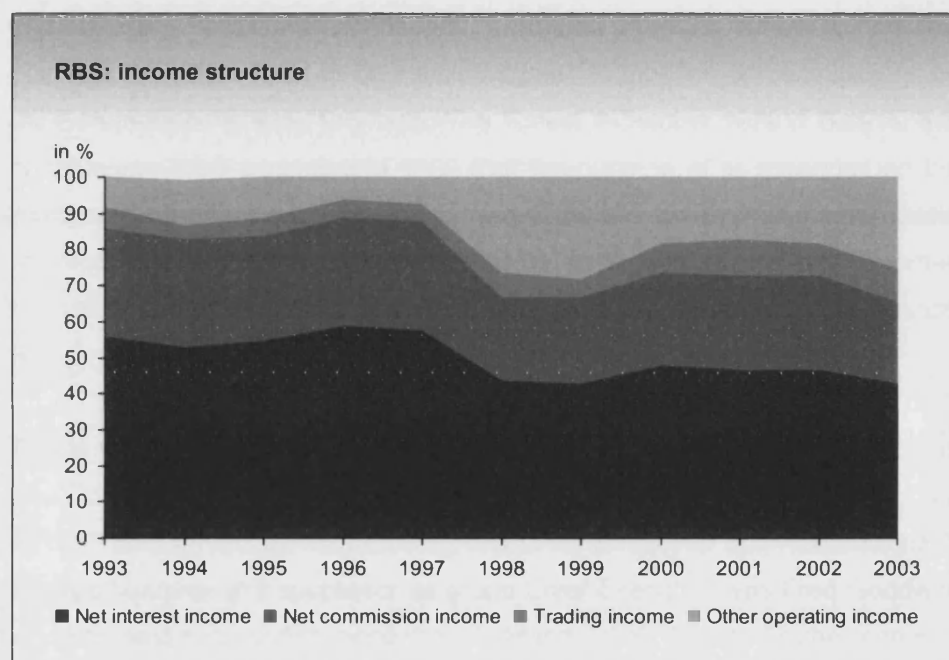
⁴ Both banks sold their cross-shareholdings, terminated their cross-directorships and formally ended the cooperation after Banco Santander's acquisition of Abbey National in 2004 (Keers, *The Daily Telegraph*, 13 November 2004; interview with Shane Glynn, 24 April 2006).

particular, the swift integration of NatWest under the auspices of Fred Goodwin, along with his selective growth strategy and tight cost control, contributed to the rise of the bank. How this small Scottish bank rose to become one of the world's leading financial institutions is analysed in the following sections, starting with its income structure.

5.2.2. Income Structure

5.2.2.1. Structural Overview

Until the acquisition of NatWest in March 2000, The Royal Bank of Scotland could be best described as a provincial Scottish bank with a successful, but relatively autonomous US subsidiary. By the early 1990s it was already clear that the bank would want to grow beyond Scotland, expanding across the whole of the UK. In the 1993 annual report management said "Our overriding objective is to become the best-performing financial services group in the UK by 1997" (RBS, Annual Report 1993).



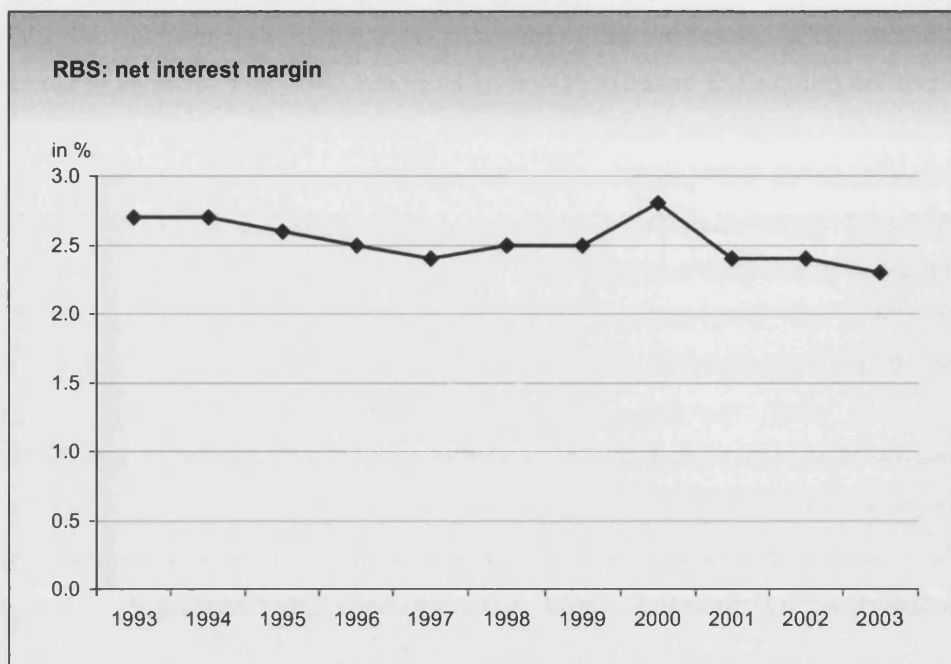
The takeover of NatWest for GBP 21 billion in March 2000 led to a quantum leap in revenues. While RBS' total operating income was still only GBP 4.1 billion in 1999, it jumped to GBP 12.1 billion during the following 15 months as the bank aligned its reporting with the calendar year. However, The Royal Bank of Scotland also demonstrated remarkable and mainly organic growth between 1993 and 1999, i.e. before the NatWest deal. During these six years, the bank grew at a compound annual growth rate (CAGR) of 18% p.a. The CAGR figure rose to 29% for the whole period (i.e. 1993-2003), reflecting the revenue boost from the takeover of NatWest.

In 1993 51% of operating profit before loan loss provisions came from branch banking, 27% came from corporate banking, 8.6% from insurance and 9.4% from the group's US business, Citizens Financial Group Inc.. The most visible structural change that occurred over the period analysed was the growing importance of the group's "other operating income". During the period analysed "other operating income" rose particularly strongly at a CAGR of 45% p.a. due to growth of the bank's insurance operations.

In 1993 net premium income was GBP 410 million and this rose to GBP 3.1 billion in 2003. The insurance activities of RBS mainly involve the direct insurer Direct Line, which was the UK's largest motor insurer in 2003. In June 2003 the bank further expanded its UK insurance business through the GBP 1.1 billion takeover of Churchill Insurance Group. The group's insurance activities will be discussed in detail in the section on retail banking.

The strong growth in The Royal Bank of Scotland's insurance operations was not matched by any of the other three types of income. Trading income shows the second strongest rise between 1993 and 2003, as its CAGR was 35% for the period 1993 until 2003. Trading income gained importance after the acquisition of NatWest, which had a greater investment banking exposure than The Royal Bank of Scotland. From 1993 until 1999 trading contributed on average 5.4% of total operating income, but this increased to 9% after the acquisition of NatWest so that for the whole period an average of 6.7% of total operating income originated from trading.

Net interest income rose on average by 26% p.a. and amounted to GBP 8.4 billion at the end of 2003. The impact of the NatWest deal on the group's net interest income was around GBP 3.6 billion in the first year. Besides this NatWest boost, the group's interest income increased faster than its interest expenses. However, as total earning assets rose even more strongly, namely by 28.2% p.a., the net interest margin deteriorated slightly over time and stood at 2.26% in 2003, compared to 2.65% in 1993. Without the NatWest acquisition the group's net interest margin would have declined further as NatWest's net interest margin was 0.2 percentage points higher than The Royal Bank of Scotland's (RBS, Annual Report 2000; NatWest, Annual Report 2000). On average, net interest income contributed 50% to the group's total operating income, although it fell from 56% in 1993 to 43% in 2003.



Commission income at The Royal Bank of Scotland accounted for some 27% on average during the period analysed. Commission income was mainly driven by fees from lending-related products such as interest rate protection schemes and mortgage securitisation. Moreover, some of the commission income originated from credit card-related fees and third-party transactions on the capital markets. Management explained in the 1993 annual report that it welcomed a high proportion of commission income as it would reduce the group's earnings volatility. It was argued that less interest income implied fewer risk-weighted assets and therefore reduced exposure to provisions for bad debts (RBS, Annual Report 1993). This line of reasoning is not plausible if one assumes that a bank should be in a position to price its loans appropriately and correctly estimate the probability of loan losses.

Throughout the period analysed the bank's profit predominantly originated from the UK market. In 1993, 78% of RBS' pre-tax profit came from the UK and 13% from the USA. At the time, only 6% stemmed from Europe. While the share of profit from the UK remained pretty stable and only fell to 74% in 2003, continental Europe gained significance and was contributing 19% of RBS' pre-tax profit in 2003, compared to just 6% in 1993. Yet these geographical shifts did not have a substantial impact on the group's income structure as such,

primarily because the US and European arms operated the same business areas as the British parent company and stayed clear of investment banking.

The bank's position as a player on the British market was consolidated by the takeover of NatWest in 2000. The deal helped it expand into the UK retail and SME market and facilitated the bank's internationalisation in the following years. In particular, RBS' corporate banking operations pursued an organic international growth strategy. As with the other case studies, the following sections will discuss the bank's investment/corporate banking, asset management and retail banking operations.

5.2.2.2. Corporate and Investment Banking

In 1993, when The Royal Bank of Scotland sold 90% of its shareholding in the merchant bank Charterhouse to a Franco-German banking partnership (CCF of France and BHF of Germany), it became clear that the management did not want to pursue a traditional investment banking strategy (Millar, *The Scotsman*, 30 January 1993). Instead of offering equity-related products and services, such as M&A consulting, RBS expanded into debt and treasury products for mid-sized and large corporate customers, mainly in the UK (RBS, Annual Report 1993). Gradually, the bank also began to offer more sophisticated debt products, for example, structured finance, trade finance, leasing and factoring. To complement its traditional treasury services it offered a wide range of foreign exchange, currency options, money markets and interest rate derivative products.

In corporate banking, The Royal Bank of Scotland pursued a relationship management approach in which it offered its customers a co-ordinated combination of these banking services. The bank's strong client orientation within a clearly defined product range allowed it to achieve high penetration of its customer base, which considerably boosted sales growth (RBS, Annual Reports 1993 & 1999; interview Achim Klüber). Corporate banking was key to RBS' strategy and was an important profit contributor throughout the period analysed. Between 1993 and 2003, the segment's contribution to the group's profit before loan loss provisions remained stable and stood at 51% in both 1993 and 2003. In absolute figures the division's profit before loan loss provisions soared from GBP 307 million in 1993 to GBP 4.4 billion in 2003.

Although the acquisition of NatWest accounted for a substantial part of this strong rise, the bank's consistent focus on these few product groups certainly helped it to excel (interview Achim Klüber). Achim Klüber, Managing Director and "Country Head Germany, Austria, Switzerland", pointed out that RBS does not try to be everything to everybody and therefore pursues a rather selective approach (interview Achim Klüber). The takeover of NatWest also raised RBS' international profile. Prior to the NatWest deal, RBS' only substantial international corporate business was done through its US subsidiary, Citizens Financial Group Inc., which it had bought for USD 440 million in 1988 (Associated Press, 1988; Lascelles, FT, 4 December 1990).

Although Citizens grew organically, its primary source of growth was a large number of acquisitions. The bank continuously extended its network throughout the New England states of Rhode Island, Massachusetts, Connecticut and New Hampshire and expanded into the Mid-Atlantic states. The December 2001 acquisition of the regional retail and commercial banking businesses of Mellon Financial Corporation⁵ for USD 2.1 billion extended the group's reach to the whole of Delaware, New Jersey and Pennsylvania and created the 13th largest commercial bank in the US. Several additional small acquisitions followed in 2003 (Royal Bank of Scotland - Announcement 2001; Fitch Ratings, 2005).⁶

RBS' US operations were its only significant international activity until 1998 when it moved into Germany, Austria, and Switzerland. At the heart of the bank's market entry strategy was the strategic use of leveraged finance and risk management solutions for large cap corporate clients (interview Achim Klüber). In these markets the bank predominantly worked with local teams and applied the same client relationship approach as it did in its UK home market. Unlike its US expansion strategy, which was acquisition-led, The Royal Bank of Scotland primarily relied on organic growth for its European strategy.

The bank's European strategy received new momentum from the acquisition of NatWest. Subsequently, the bank expanded into Spain (2001), France (2001), and Italy (2002).⁷ The Royal Bank of Scotland decided to set up branches for its European operations rather than subsidiaries as these would be regulated by its home regulator, i.e. Britain's FSA. This helped it benefit from scale efficiencies due to its size in the UK. In Germany, for example, it used the same IT systems it had in place in the UK and did not have to modify them to meet the requirements of Germany's Bafin as it was regulated by the FSA (interview Achim Klüber). Scale efficiencies were also the driving force behind the bank's custody business which will be discussed in the next section.

⁵ The acquisition added USD 13.4 billion of assets, 345 branches and 4,135 employees in Pennsylvania, Delaware and New Jersey. The transaction increased Citizens' deposit base by 54%, the number of personal customers by 50%, and business customers by 48%. Following this deal Citizens Group had USD 47 billion assets, around 11,400 employees and 770 branches across seven states (Royal Bank of Scotland - Announcement 2001).

⁶ In August 2004 Citizens bought Charter One Financial Group, thereby expanding the group into another six US states (Illinois, Indiana, Michigan, New York, Ohio and Vermont) (Fitch Ratings, 2005).

⁷ RBS has been present in Greece since 1973. The bank has become the world's leading lending institution to the Greek shipping market. Available from: http://www.rbs.com/about01.asp?id=ABOUT_US (Royal Bank of Scotland, undated) [Accessed 17 June 2006].

5.2.2.3. Asset Management

Between 1993 and 2003 asset management, i.e. mutual funds (retail funds) and institutional asset management, did not play a significant role for RBS' strategy. The bank initially offered administration services for PEPs (personal equity plans), unit trusts, investment trusts and investment trust savings schemes through a unit known as Securities Service. Following the acquisition of the custody business of S.G. Warburg in 1997, the RBS Trust Bank was formed to bring the group's securities services and global custody services under the same roof (RBS, Annual Report 1997). As a result of this deal the RBS Trust Bank became one of the leading UK custodian banks with GBP 250 billion assets under custody and an estimated UK market share of 20-25% (Denton, FT, 2 August 1996; Turpin, The Scotsman, 22 February 1999). The Royal Bank of Scotland also gained Warburg's main custody client, Mercury Asset Management, which was at the time UK's largest fund manager (Denton, FT, 2 August 1996).

Yet it appears that, despite these attempts to grow, RBS could not achieve the necessary size to operate its custody business profitably. In 1996, the Investor Service segment ran up a loss of GBP 17 million followed by a further loss of GBP 12 million in 1997 and finally a small profit of GBP 5 million in 1998. During the 1990s the custody business became highly commoditised and economies of scale became the decisive competitive factor. Management concluded after less than two years that the RBS Trust Bank would not gain the size required to compete successfully on a global scale and without much ado the bank's custody business was sold in spring 1999 to the Bank of New York for GBP 500 million (AFX News, 23 March 1999).

Through the takeover of NatWest The Royal Bank of Scotland gained control over Gartmore, the asset management arm of NatWest. This time, management was even quicker to decide what to do with the business and Gartmore was sold to US-based Nationwide Mutual Insurance for GBP 1.03 billion in March 2000. RBS exercised its option to purchase Royal Bank of Scotland Portfolio Management and Royal Bank of Scotland Unit Trust Management from Newton Management Limited⁸ equally quickly in December

⁸ The Royal Bank of Scotland sold its 33% stake in Newton Management to Mellon Bank of the US for GBP 56 million in 1998 after it had bought it in 1994 for GBP 25 million following the merger between Newton Management and RBS' investment subsidiary Capitol House (Powell, The Herald, 25 July 1998; Willcock, The Independent, 17 September 1994).

2002. Only two months later, 49% of RBS' Unit Trust Management was sold on to the British insurer Aviva, with which RBS already had a retail distribution agreement (RBS, Annual Reports 2002 & 2003). The bank's multi-brand strategy and the different distribution channels used for its retail operations will be at the heart of the next section of this case study.

5.2.2.4. Retail Banking

While asset management, apart from brief custody intermezzo, did not have any real bearing on the group's strategy, retail banking ranked alongside corporate banking as one of RBS' two main business areas. In fact, retail banking was of such significance that management drew a distinction between direct retail and traditional retail banking. For the purpose of this research and consistent with the other case studies, the section on retail banking also includes wealth management and the bank's insurance operations. Subsuming all of these segments under retail banking means that in 1993 43% of pre-tax profit after loan losses (excluding Citizens⁹) came from business with private clients. The bank's private clients contributed 69% of pre-tax profit in 2003, reflecting the improved efficiency, which was mainly due to greater use of technology, and the improved loan loss situation in the UK.

The Royal Bank of Scotland recognised that the quality of service and innovation are often the differentiating factors in the financial services industry. Thus, management gave high priority to investment in staff, training and development to guarantee customer satisfaction (RBS, Annual Report 1995). In retail financial services, The Royal Bank of Scotland grew its business by offering banking and insurance products through different channels and under different brands. This enabled it to appeal to various customer groups.

In its 1993 annual report management stated that its objective was to become the best retail bank in Britain by 1997. This upbeat outlook was based on the somewhat equivocal definition that the best bank is the one with the highest aggregate rating from everyone involved in the business, i.e. customers, staff and shareholders (RBS, Annual Report 1995). Nevertheless, it still illustrates that management was clearly committed to its retail banking operations. In 1992 RBS had launched the "Columbus" project, which comprised reorganising almost every aspect of branch banking to better meet the needs of customers.

In early 1993, The Royal Bank of Scotland reviewed its delivery channels and subsequently launched Direct Banking, a 24-hour, seven-day-a-week telephone banking service. This more differentiated distribution structure

⁹ Citizens operated retail and corporate banking but no split between these two business areas was disclosed in RBS' annual reports.

eventually led to the bank's Retail Direct segment.¹⁰ Retail Direct, initially known as New Retail Financial Services Businesses, was set up as a separate segment in 1997, the year when RBS launched a joint venture in financial services with Tesco, at the time the UK's leading supermarket group.¹¹

Through the joint venture with Tesco alone, The Royal Bank of Scotland gained more than 4 million new retail clients between 1997 and 2003. According to management, Tesco Personal Finance became one of the UK's fastest growing financial services operations due to the combination of in-store facilities and high-quality direct service (RBS, Annual Report 2003). RBS' US arm had already opened a series of in-store full-service retail branches in 1995 at Shaw's Supermarkets, a New England grocery chain owned by Sainsbury (RBS, Annual Report 1995).¹²

Using existing retail structures as a means of selling financial products was also at the heart of the bank's partnership with the German coffee retailer Tchibo. This cooperation, launched in autumn 2003, spearheaded its entry into the continental European consumer finance market. Initially, The Royal Bank of Scotland sold fixed-term loans and stand-alone alternatives to bank overdrafts through Tchibo's 870 stores. According to CEO Fred Goodwin, the German banking landscape was so fragmented that a market entry strategy should not focus on large acquisitions. Instead, the bank relied on distribution agreements like the one with Tchibo, which had previously been unheard of in the German retail sector (Börsen-Zeitung, 1 October 2003; Schmid, FT, 25 June 2004; interview Achim Klüber).

The Royal Bank of Scotland further expanded its German retail operations through smaller acquisitions such as the German credit card and personal loan portfolios of Frankfurt-based Santander Direkt in 2003. At the time

¹⁰ By 2003 Retail Direct offered financial services and banking products directly to consumers through a range of channels, which included well-known brands such as Tesco Personal Finance, The One accounts, Direct Line Financial Services, Lombard Direct and in Europe, Comfort Cards. It also offered a comprehensive range of credit and charge cards (RBS, Annual Report 2003).

¹¹ In 2003 Retail Direct also comprised Direct Line Financial Services, offering mortgages, life assurance, savings accounts, a PEP unit trust and pensions, RBS Advanta, the bank's credit card business, and Direct Line Accident Management (RBS, Annual Report 2003).

¹² The bank's US retail operations grew as Citizens continuously expanded throughout the New England states and the Mid-Atlantic region of the US primarily through acquisitions. In 1993 Citizens operated more than 125 bank branches in Rhode Island and the neighbouring states of Connecticut and Massachusetts, with a strong presence in Boston, as well as 28 mortgage banking branches in the eastern USA (RBS,

Santander Direkt was the third-largest credit card provider in Germany with 490,000 customer accounts and its credit card and loans portfolio was valued at EUR 486 million (Croft & Levitt, FT, 15 May 2003).

Alongside its differentiated retail banking approach, the bank has also offered insurance solutions to its retail clients since 1985. Unlike many other banks, RBS did not buy an insurance company but entered insurance as a venture capitalist. It funded¹³ Peter Wood's idea that motor insurance could be underwritten profitably using computer-based technology and sold directly to the public over the phone. Operating as Direct Line, the group's insurance arm gained quickly market share in the UK motor insurance business by cutting out the traditional intermediary, namely the insurance agent (Royal Bank of Scotland, 2005). In October 1988, Direct Line also launched home insurance, based on the same model as its original motor insurance product.

During the 1990s, Direct Line continued to broaden its focus, developing new products and expanding its operations to other financial services (Royal Bank of Scotland, 2005).¹⁴ By 1993 Direct Line had become the UK's largest private motor insurance company with 1.25 million insured vehicles (RBS, Annual Report 1993). At the end of 2003, it was still the number one motor insurance company with over 8 million UK motor policies in force and had emerged as the number two for UK household insurance, following the GBP 1.1 billion takeover of Churchill Insurance Group (RBS, Annual Report 2003). In 1993 Direct Line's pre-tax profit was GBP 50 million and thus contributed some 17% to RBS' pre-tax profit in that year. By the end of 2003 the group's insurance operations generated a pre-tax profit of GBP 438 million but had lost ground in relative terms as their contribution to pre-tax profit was down to 6.5%.

As Direct Line did not have any bricks-and-mortar branches, it had to rely heavily on advertising and marketing. In 1990, the company introduced the logo of a red telephone with wheels to establish a cheerful and friendly corporate identity. According to the company's founder Peter Wood, who left the company in 1997 (Graham, FT, 26 June 1997), the great success of Direct Line came from a good computer system, well-motivated, well-trained staff

Annual Report 1993). By 2003, Citizens had 2.4 million personal customers and was the fourth largest supermarket bank in the US (RBS, Annual Report 2003).

¹³ The initial funding was GBP 20 million.

and good marketing (The Scotsman, 6 October 1992). Moreover, Direct Line had a conservative investment approach, keeping premium money mainly invested in cash and gilts. Wood was quoted as saying: "I'm already in the risk business - I don't have to be in it twice. I'd rather get 8 per cent year-on-year, than do 30 per cent one year and go bust the next" (The Scotsman, 6 October 1992).

Direct Line was also used to spearhead expansion into other European countries. First, it expanded into the Spanish insurance market through a motor insurance joint venture with Linea Directa in 1995, which applied the same strategy as in its domestic market. In June 2001, Direct Line acquired the Italian and German motor insurance operations of the US insurer Allstate. This, combined with the purchase of Royal & Sun Alliance's direct motor operations in Italy in the following year, made it Italy's largest direct motor insurer. By the end of 2003, Direct Line was the largest direct insurer in Spain and Italy and had made inroads into the German market (Royal Bank of Scotland, 2005).

Through the acquisition of NatWest The Royal Bank of Scotland gained control over a substantially larger private banking business, principally through Coutts & Co. Subsequently, a separate Wealth Management segment was established. This comprised Coutts, Adam & Company and the offshore banking businesses of The Royal Bank of Scotland and NatWest. Adam & Company is a private bank operating primarily in Scotland which RBS acquired in 1993. Coutts is one of the UK's leading private banks, providing services to around 20% of the country's wealthiest individuals. In 2003, Coutts purchased the Swiss private bank Bank von Ernst from Credit Suisse.¹⁵

The bank's traditional, mainly UK-based high street branch banking received the largest earnings boost from the NatWest acquisition. The NatWest deal was to a great extent a domestic retail banking expansion, with a complementary branch structure. While The Royal Bank of Scotland enjoyed a strong foothold in the Scottish market, its home market, NatWest was particularly strong in England. Due to the complementary branch structure and

¹⁴ Direct Line began to offer non-insurance products, such as loans, mortgages, savings accounts, a PEP unit trust, pensions and life insurances.

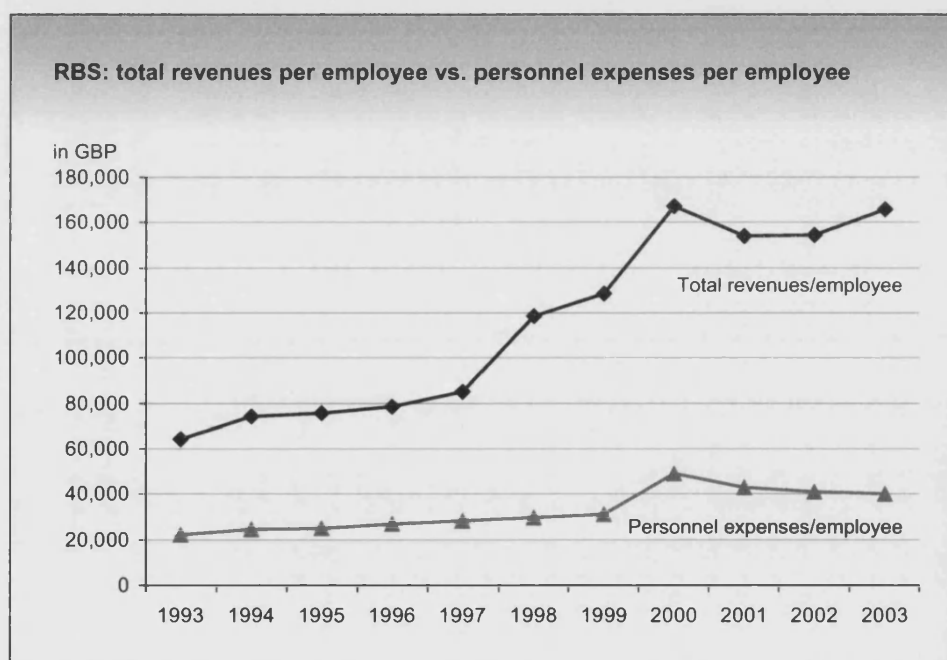
¹⁵ At the end of the same year, Coutts had 36 offices worldwide and GBP 35 billion assets under management on behalf of 70,000 clients (RBS, Annual Report 2003).

RBS' multi-branding strategy – i.e. keeping the NatWest branches alongside those of RBS – the number of branch closures was limited and did not encounter major political resistance. In fact, The Royal Bank of Scotland increased the number of staff in NatWest branches as it realised that customer satisfaction was low due to understaffing (Croft, FT, 4 January 2003).

The Royal Bank of Scotland stopped NatWest's closure programme and undertook measures to regain the confidence of staff and customers. Across the NatWest branch network 1,000 customer advisers were appointed, to implement RBS' sales and service approach (Royal Bank of Scotland, 2000b; RBS, Annual Report 2002). Although the acquisition of NatWest did not entail a reduction in the number of branches, the deal still allowed the group to realise substantial cost-savings and cumulative benefits of GBP 5.5 billion (Croft, FT, 8 October 2004). The group's cost and risk management, particularly in the light of the NatWest deal, will be discussed in the following section.

5.2.3. Cost and Risk Management

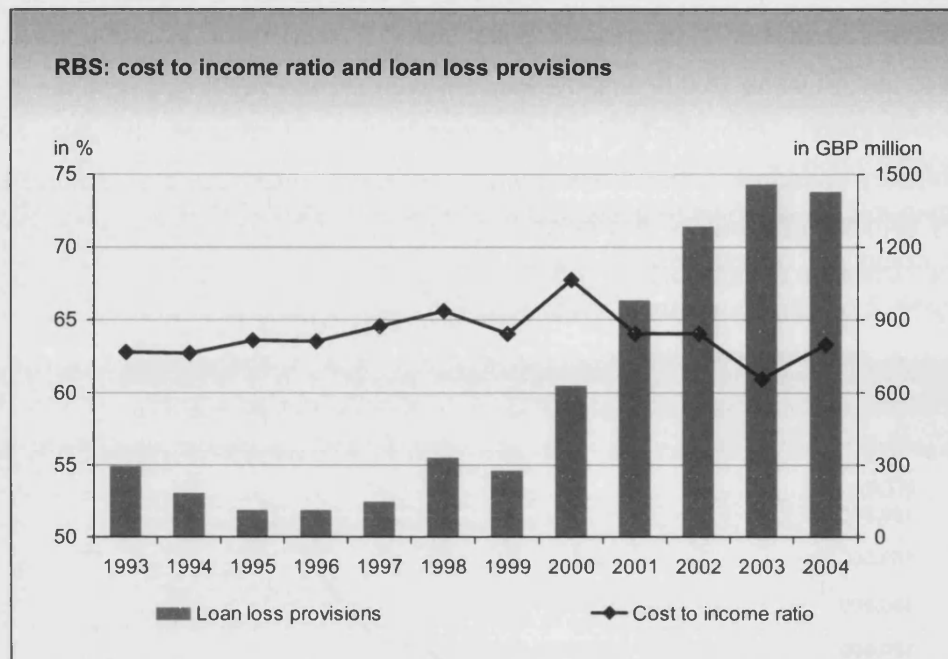
Given that NatWest was about twice the size of The Royal Bank of Scotland in terms of total assets, it is clear that the takeover had substantial implications for the group's cost and risk structure. The integration process entailed 18,000 job cuts over a period of about two years. Drastic as these measures appear, NatWest explained in its defence document that as a stand-alone unit it had also laid off some 15,000 employees (Jamieson & Flanagan, *The Scotsman*, 1 March 2002). The majority of job cuts were in the back office and the group's treasury department, thus in areas where scale efficiencies could be achieved by eliminating overlaps. According to Fred Goodwin¹⁶, none of these 18,000 job cuts were compulsory redundancies (Croft, FT, 4 January 2003).



The proportion of personnel expenses relative to the bank's total operating expenses before risk provisions declined from 55% in 1993 to 40% in 2003. In 2003 RBS employed an average of 116,350 staff, compared to 23,708 in 1993. Obviously, the largest boost came from the NatWest acquisition, which added some 55,800 employees to the group (NatWest, Annual Report 2000). While RBS' total personnel costs per employee rose at a compound annual

¹⁶ Fred Goodwin who oversaw the deal as CEO of The Royal Bank of Scotland had already earned the nickname "Fred The Shred" for his cost-cutting exercises while at Clydesdale Bank (part of The Royal Bank of Scotland Group) (Croft, FT, 4 January 2003).

growth rate of 6.0% during the period analysed, average revenues per employee rose by a remarkable 9.9% p.a. This explains the strong average growth in pre-tax profit per employee during the period analysed. In 1993 pre-tax profit per employee was GBP 10,882. This rose to GBP 52,222 in 2003 - a CAGR of 17%.



As previously discussed, the complementary location of RBS and NatWest branches did not lead to any major closures. Another reason why the closure of bank branches could be avoided following the acquisition was the "Columbus" efficiency improvement project which RBS had launched in 1992. This was a five-year restructuring plan for the bank's 780 retail branches (figures relate to 1992). The initiative comprised major IT investments and cutting 3,500 jobs, i.e. 27% of the 13,000 people working in branches at the time (Gapper, FT, 20 November 1992). Because of these measures, management expected the cost income ratio to fall from 68% to 53% (Gapper, FT, 20 November 1992). However, according to the standardised Fitch data used for this research, the cost income ratio consistently stayed above 62% until 2003 and was on average 64% between 1993 and 2003.¹⁷

¹⁷ In contrast to the data used for this research, the cost income ratio published by RBS continuously improved over the years, with a widening gap between the standardised calculation and the one stated by the company. In 1993, the discrepancy was still just 5.6% but increased to 18.9% in 2003. The Royal Bank of Scotland's calculation of its cost income ratio represents operating expenses excluding goodwill

Besides reducing the number of employees, the NatWest deal also brought additional cost savings as a result of the integration of IT systems. Effectively, NatWest's 446 IT systems were migrated into those of RBS which were a quarter of the size and were considered simpler and cheaper (Croft, FT, 4 January 2003). The Royal Bank of Scotland's IT integration was completed in October 2002, several months ahead of schedule. In recognition of this management paid a 5% integration bonus to all employees whose business units were involved in the process (RBS, Annual Report 2002).

The Royal Bank of Scotland also took a close look at the sales and service approach of Natwest. The sales process was streamlined by appointing over 1,000 customer advisers across the NatWest branch network. Moreover, all back offices were removed from NatWest branches and the bank's branches underwent a GBP 150 million refurbishment. Finally, in 2002 The Royal Bank of Scotland announced that the cumulative benefits of the NatWest integration programme were GBP 5.5 billion, which was GBP 1.4 billion more than originally planned (Croft, FT, 4 January 2003). Management's ability to exceed its own targets had also been helped by the fortunate circumstance that NatWest's pension fund carried a higher than expected undeclared surplus.¹⁸

The acquisition of NatWest certainly represented the largest single risk RBS' management took during the period analysed. A takeover on such a scale bears, for example, the risk of buying a loan portfolio that is not sufficiently provisioned for, or that is not adequately diversified and simply wrongly priced. Moreover, a hostile takeover of this sort involves multiple integration risks. These range from "soft factors" such as the compatibility of two distinct corporate cultures to the aforementioned integration of IT systems. During a phase of uncertainty, employees could also feel inclined not to act in the interest of the company. For instance, traders could try to take riskier positions than they would otherwise do.¹⁹

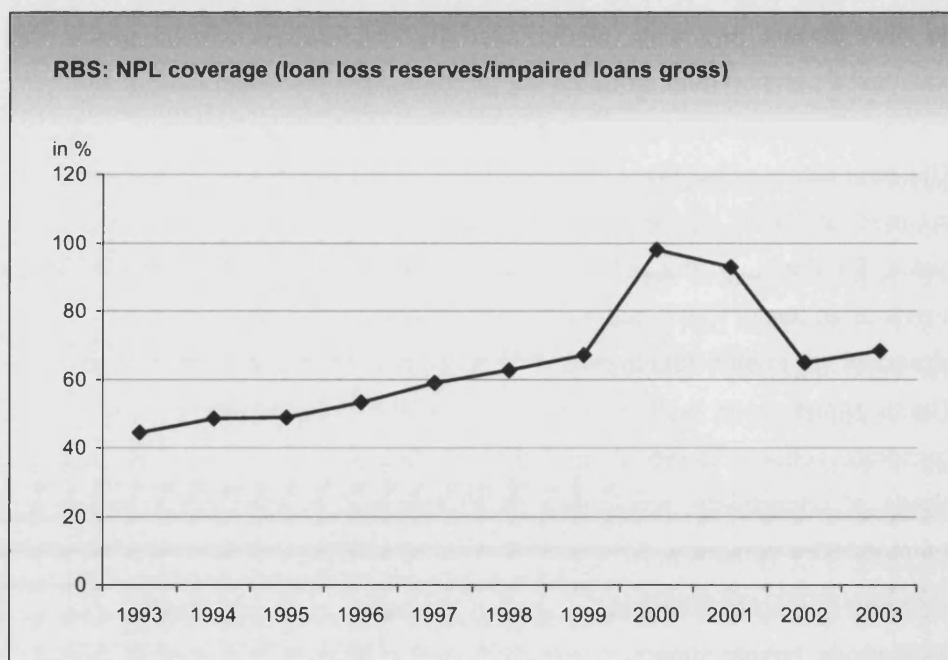
amortisation and integration costs, and after netting operating lease depreciation against rental income, thus providing a distorted picture.

¹⁸ It was reported that The Royal Bank of Scotland uncovered an undeclared surplus of up to GBP 2 billion in the pension fund of the National Westminster Bank (Garfield, *The Independent*, 22 May 2000).

¹⁹ Martin Taylor, Barclays' former CEO, pointed out during the interview for this research that he was very wary of the changed risk attitude of the bank's traders when it became public that the group's investment banking arm was up for sale.

Compared to the risks that the acquisition of NatWest entailed, the bank's other operational risks appeared relatively exiguous. The Royal Bank of Scotland's decision to build its own insurance operations did not simply require the bank to pursue a strategy that clearly distinguished it from other established insurers. It meant it also had to have control over the structure and price of the risks underwritten. Organic growth through Direct Line allowed RBS to underwrite mainly retail insurance and thus avoid large commercial risks.

The Royal Bank of Scotland's management avoided aggressive expansion into traditional investment banking during the hype of the late 1990s. It did not endeavour to build a track record of transactions by granting inadequately priced loans in return for investment banking mandates. The bank's disciplined strategy of remaining focused on debt capital market products and structured finance almost certainly contributed to the good quality of its loan portfolio. Consequently, the pricing of loans seemed to adequately reflect the underlying risk, justifying the group's moderate coverage ratio.



Possibly management's confidence in its risk management can be considered as an explanation for a coverage ratio that remained below 100% throughout this period. Only in 2000/2001 did it nearly reach 100% but thereafter it fell

back to its previous level, with a long-term average (1993-2003) of 64%. Rather than taking a critical view of the weak coverage ratio, one may argue that the group's strong profitability justified the moderate level of the bank's loan loss reserves. RBS has a rigorous "checks and balances" system in place with regards to granting loans. The bank's client relationship managers are questioned by the loan officers in front of a management panel, which then decides whether a loan should be granted or not (interview Achim Klüber).²⁰

Further anecdotal evidence about the group's good credit quality is provided by its US subsidiary. According to the 1993 annual report, Citizens had the best credit quality of any major bank in New England, with the lowest bad debts and the lowest ratio of non-performing assets to performing assets (RBS, Annual Report 1993). Citizens' CEO pursued a prudent lending policy which he summarised as "if you can't drive to it, don't lend to it" (Jamieson & Flanagan, *The Scotsman*, 1 March 2002). In fact, there is evidence that the distance between lender and creditor matters for the quality of the loan. It is argued that the probability of the loan turning bad increases with the distance between lender and creditor (Marquez & Hauswald, 2004; Degryse & Ongena, 2005; Liberti & Mian, 2006). Thus RBS' cautious and regional US expansion contributed to the group's asset quality.

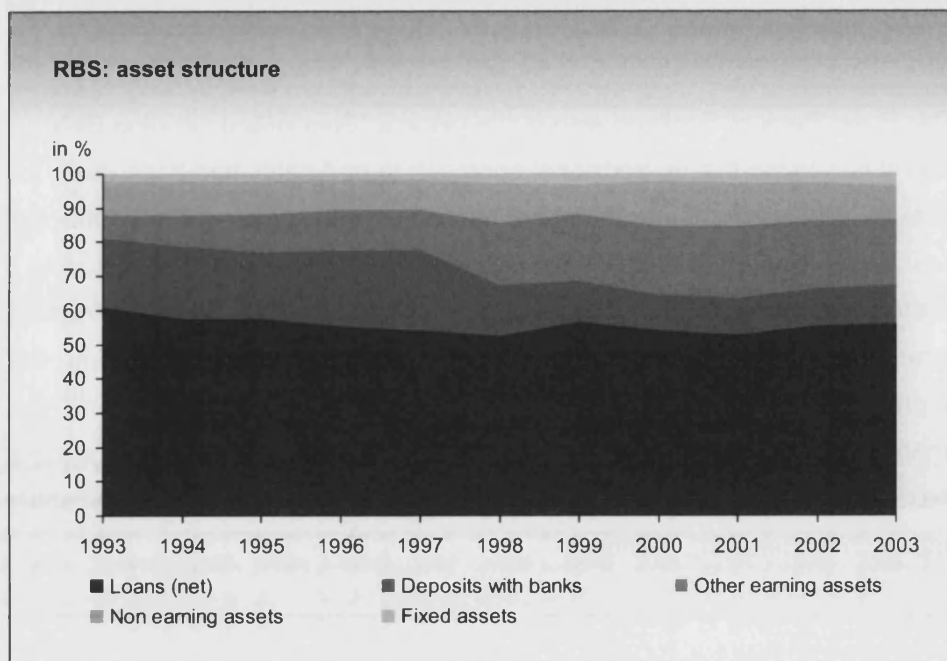
The Royal Bank of Scotland also put in place a "Specialised Lending Service" after it had found that its traditional approach to bad debts had been much too passive. Management argued that relationships with customers in trouble can best be handled by individually assessing each business and by developing a strategy with the customer that involves restructuring the customer's financial arrangements and the customer's business. According to management, this approach made a major contribution to dealing with problem loans and enabled businesses which were fundamentally sound to survive and prosper (RBS, Annual Report 1993). Effectively this approach is an asset-liability approach to managing clients.

²⁰ These discussions are usually international video conferences with changing members of the management panel.

5.2.4. Asset-Liability Structure

From 1993 until 2003 RBS' total assets grew at a compound annual growth rate of 28% p.a. This figure is slightly misleading as the acquisition of NatWest meant that the group's balance sheet total increased to GBP 309 billion in 2000, compared with just GBP 87 billion in the previous year. Despite this quantum leap in terms of balance sheet size, the takeover of NatWest did not substantially alter the asset structure.

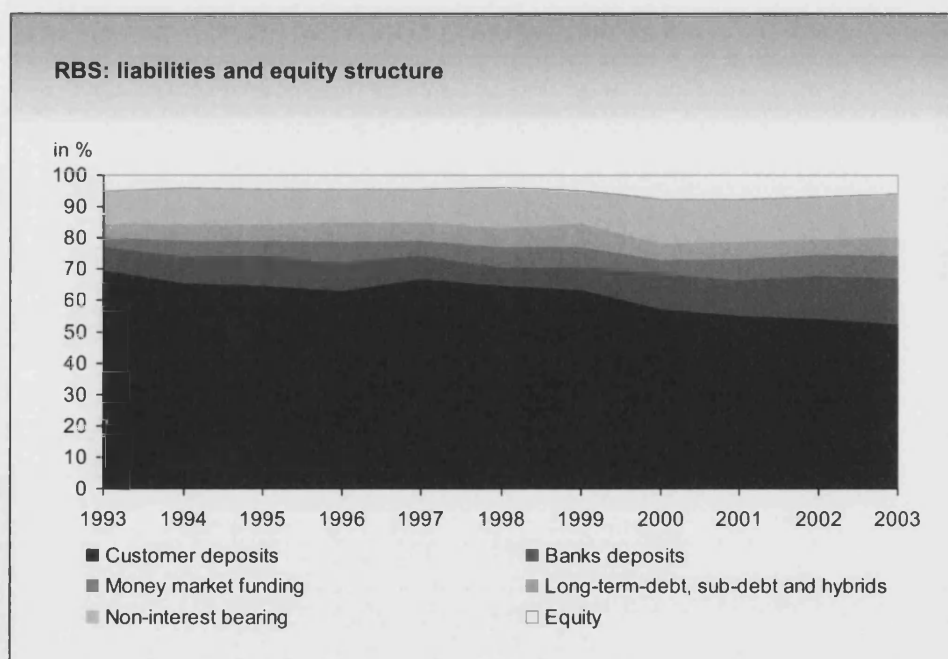
Net loans as a proportion of total assets declined from 63.5% in 1999 to 57.3% in 2000. The average was 56% in this period. Notwithstanding the takeover of NatWest, The Royal Bank of Scotland grew its loan portfolio on average by 13.8% p.a. between 1993 and 1999. The most striking structural shift on the asset side was the relative decline in deposits with banks, which fell from 20% of total assets (1993) to 10% (2003). This development was mirrored by the growing significance of total other earning assets, which rose from 7% (1993) to 19% (2003). These other earning assets mainly resulted from the bank's insurance operations and the assets held for investment.



The bank's non-earning assets as a percentage of total assets remained relatively stable at around 10% until 2000 when the goodwill from the NatWest

takeover had to be disclosed in the balance sheet. RBS reported goodwill of GBP 11.4 billion from the NatWest deal. Goodwill refers to the difference between the fair value of the price paid for a business and the fair value of its net assets (Oxford Dictionary of Finance and Banking, 1997). The different accounting treatments of "goodwill" illustrate how a company's cost and risk management is interconnected with its balance sheet structure.

Prior to the NatWest deal, The Royal Bank of Scotland would write-down any goodwill in the year of acquisition, effectively leaving no goodwill on the balance sheet. Following the NatWest deal, management and the auditors agreed that the goodwill of GBP 11.4 billion would be amortised over its estimated useful life of 20 years, resulting in an annual charge of GBP 570 million as of 2000 (RBS, Annual Report 2000). In addition, the auditors had to test the level of goodwill annually to see if it reflected a value that could be justified as an intangible or if it was identified as being impaired. Impairment would entail a value adjustment and therefore a write-down in excess of the annual amortisation charge, thus reducing profitability.



Due to the bank's expansive lending policy, its tier 1 ratio did not rise significantly and was just 7% on average (1993-2003). The relatively low tier 1 ratio also resulted from an average payout ratio of 40% and the use of hybrid,

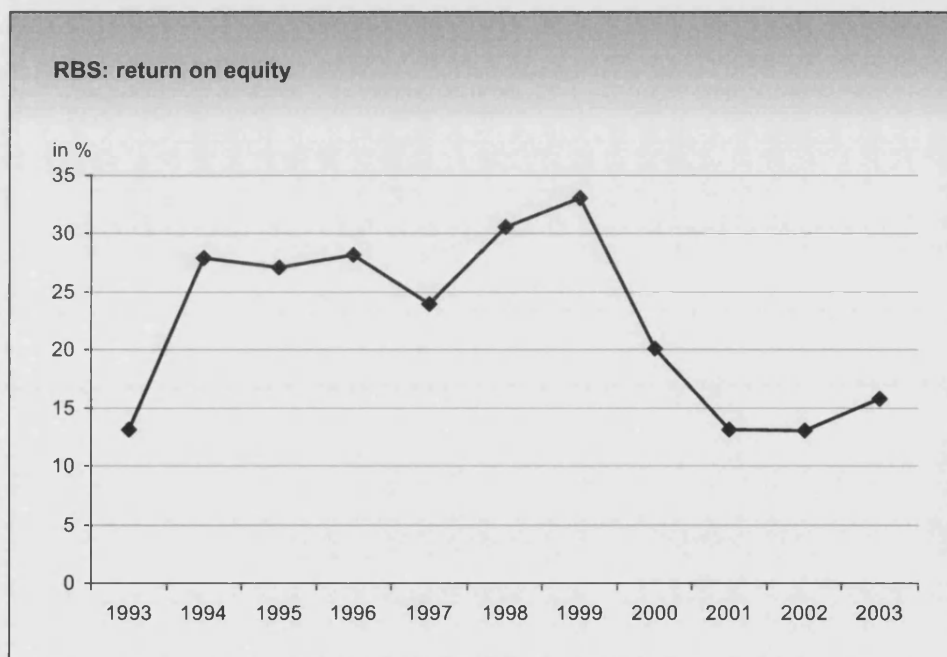
subordinated debt and other long-term debt instruments that provided 5.6% of the group's funding on average. On the liabilities and equity side of the balance sheet, the most remarkable structural change was the continuous decline in customer deposits relative to total liabilities and equity. In 1993, 69.7% of the bank's funding still came from customer deposits. This declined over the following decade and was 49.2% in 2003. During this period it was primarily replaced by bank deposits²¹ and money market instruments.

While more banks deposited money with RBS (shown as liabilities), RBS itself deposited less money with other banks (shown as assets). Deposits from other banks rose from 7.6% in 1993 to 17.1% in 2003, thus on average 9.7% of total liabilities were deposits from banks. This pattern is rather unusual and does not reflect the common trend towards disintermediation. A more active role on the debt capital markets and the resulting larger trading positions contributed to this development, which also reflects its services to other financial institutions, i.e. its role as a bank to other banks.

²¹ This refers to funding provided by other banks.

5.2.5. Profitability

Net profit at The Royal Bank of Scotland underwent two major hikes between 1993 and 2003. The 1993 and 1994 results show clear signs of the improved macroeconomic environment in the UK. Loan loss provisions fell from GBP 396 million in 1992 to GBP 293 million in 1993 and to GBP 182 million in 1994. Thus, net profit soared during 1993 and 1994 compared to 1992 when it was just GBP 21 million, giving a return on equity of 1.3%. The second major earnings boost came from the takeover of NatWest in 2000, which lifted the group's net profit to GBP 2.2 billion in 2000 (for 15 months) from GBP 850 million in 1999, although ROE fell from 33% (1999) to 20% (2000).



During the period analysed, RBS' net profit grew on average by 37.1% p.a., while its total operating income increased at a compound annual growth rate of 28.9%. In absolute figures the group's net profit rose from GBP 178 million in 1993 to GBP 4.8 billion in 2003. While the bank's revenues and profits rose strongly in absolute terms, its return on equity actually weakened after the takeover of NatWest. From 1993 until 1999 the group's post-tax ROE was on average 26%, whereas it fell to just 16% in the years immediately after the NatWest deal. However, the average ROE figure for the period between 1993 until 2003 was a remarkable 22% after tax.

The reduced return on equity after the acquisition of NatWest was also a reflection of the bank's higher capitalisation, as the tier 1 ratio was on average 7.2% between 2000 and 2003 in contrast to 6.8% for the years prior to the NatWest deal. Shareholders' equity became a more important source of funding for the group, possibly in order to maintain the rating awarded by the international rating agencies (S&P, Moody's, Fitch). The proportion of common equity relative to total assets rose on average from 3.3% before the acquisition of NatWest to 6.2% after the takeover, supporting the argument that the weakened profitability in terms of ROE was also due to higher equity capitalisation. The rising tier 1 ratio also resulted from the fact that the group's risk-weighted assets grew more slowly than its shareholders' equity.

The group's high profitability and strong profit growth were fuelled by a management approach that pooled resources and realised scale efficiencies through the use of a common group-wide platform and common standards wherever feasible. Moreover, management pursued a stringent cost control policy, while maintaining sufficient entrepreneurial flexibility to develop attractive new businesses (interview Achim Klüber). If the bank had slavishly sought to meet a profitability target, management might have forgone some of the group's most interesting business opportunities. For example, in contrast to Lloyds TSB, RBS could diversify into other business lines, internationalise its operations and act as a venture capitalist, as in the case of Direct Line. Ultimately, this contributed to its profit growth.

5.2.6. Conclusion

RBS did well in striking the balance between managing its costs and risks while granting its key staff sufficient entrepreneurial freedom.²² This entrepreneurial freedom fuelled the development of innovative solutions and enabled the bank to go unprecedented ways. Therefore, the strategy adopted by RBS shows a relatively unique and original pattern as it did not try to be everything to everybody. Instead, management appeared to have a clear awareness of which businesses it wanted to avoid. Management's selective strategic approach may therefore be described as opportunistic and does not make it particularly easy to identify an over-arching corporate strategy.

It could be concluded that RBS' corporate strategy was the successful management of business portfolios with distinct business strategies that did not follow a common rule. However, on an operational level, in order to realise scale efficiencies management tried to use a common platform, standardise procedures and use a joint purchasing approach for as many operations as possible. The bank's incessant quest for efficiency improvements and its stringent cost control were also driven by the idea that size matters.

Throughout the period analysed, the bank's profit predominantly originated from the UK and RBS' management did not express any global aspirations. In 1993, the purpose of RBS' European operations was merely to serve its UK banking customer base and management regarded the US activities solely as a means of diversifying earnings (RBS, Annual Report 1993). Despite RBS' 1988 agreement to cooperate with the Spanish banking group Santander, its US operations were the only relevant international activity until 1998 when it finally expanded into Germany, Austria, and Switzerland.

Unlike its US operations, which grew through many regional acquisitions, RBS' European expansion was primarily organic²³ and followed a focused niche strategy. The bank's European strategy received new momentum following the acquisition of NatWest. Subsequently, it expanded into Spain

²² While at the end of 1993 The Royal Bank of Scotland was still a provincial bank, which employed some 23,700 people, and operated with GBP 37.2 billion of assets, a decade later 116,350 people worked for RBS, which by then had grown its assets to GBP 451 billion.

²³ In Germany RBS explicitly ruled out any major takeovers. CEO Fred Goodwin considered the German banking market to be too fragmented for any takeover to provide a substantial market share.

(2001), France (2001), and Italy (2002) and the share of profit from Europe gained significance, contributing 19% of RBS' pre-tax profit in 2003, compared to just 6% in 1993.

As explained in RBS' 1993 annual report, management wanted the group to become "the best-performing financial services firm in the UK by 1997" (RBS, Annual Report 1993). This rather broad statement provided some indication of what was to come in the following years. It was already clear at the time that management wanted to concentrate on the domestic market and actively participate in consolidation in order to grow.²⁴ Yet, it hardly did so, until 1997 – and maybe therefore felt even greater pressure to win the battle for NatWest in 2000.

Clearly, the hostile takeover of the much bigger NatWest was the strategic masterpiece of RBS' management during the period analysed. Besides the actual deal, the relatively smooth integration and the subsequent creation of a multi-brand powerhouse required managerial vigour and a clear understanding of power structures within the organisation.

²⁴ Moreover, the term "financial services" suggested that it would want to pursue a balanced business model with retail and corporate banking as well as insurance operations.

5.3. Deutsche Bank AG

5.3.1. Introduction and Status Quo in 1993

When it was founded in 1870, Deutsche Bank's primary goal was to challenge the hegemony of British banks, which dominated the financing of German foreign trade¹ (Gall et al., 1995; Pohl & Burk, 1998). Deutsche Bank's statute emphasised its future role in foreign trade and explicitly stated that "the object of the company is to transact banking business of all kinds, in particular to promote and facilitate trade relations between Germany, other European countries and overseas markets" (Gall et al., 1995).

Deutsche Bank's founding fathers were the first in Germany to recognise that the savings of domestic depositors are an attractive source of financing.² With this understanding of asset-liability management Deutsche Bank expanded from financing international trade to financing domestic industrial investment.³

Like many other large German banks, its international operations had come apart during the Nazi era and in particular during the Second World War. As an important financier to Germany's export-oriented industry, Deutsche Bank gradually regained its international position during the 1950s and 1960s as the country's economy was being rebuilt. During that post-war period, the country also moved from being a debtor to being a creditor nation.⁴

Although the 1950s and 1960s laid the foundations for Deutsche Bank's role as a global financial powerhouse, its main period of international expansion was in the 1970s. Between 1976 and 1979 it opened branches in London, Tokyo, Paris, Brussels, Antwerp, New York, Hong Kong, Milan and Madrid.⁵ This renewed internationalisation was followed by an effort to branch out into

¹ Available from: http://www.deutsche-bank.de/geschichte/en/html/index_m.htm (Deutsche Bank AG, undated) [Accessed 17 December 2004].

² In 1929, Deutsche Bank merged with its competitor Disconto-Gesellschaft, founded in 1851. Both institutions were of comparable size and the merger has been described as merger of equals. Available from: http://www.bankgeschichte.de/index_04.html (Deutsche Bank AG, undated) [Accessed 17 January 2007].

³ Since its early days, Deutsche Bank has been characterised as a "universal bank". Although there is no unequivocal definition of a universal bank in the academic literature, this term is generally used to describe banks which provide a large variety of financial services to a broad range of clients (Canals, 1996), with a high proportion of earnings coming from transformation activities (Hartmann-Wendels et al., 2000, p. 29).

⁴ Available from: http://www.deutsche-bank.de/csr/en/history/7605_7631.html# (Deutsche Bank AG, undated) [Accessed 15 January 2005].

other retail markets in an attempt to build a pan-European retail network throughout the 1980s.

Most prominent was the bank's early engagement in Italy through the USD 600 million (DM 1.2 billion) acquisition of Banca d'America e d'Italia in 1986. Following several transactions, including the 1989 takeover of UK merchant bank Morgan Grenfell and the takeover of Banco de Madrid in 1993, Deutsche Bank earned around 26% of its operating profit in 1993 through its foreign subsidiaries. At the time 16,271 employees, that was 22% of the group's staff, worked in 697 international branches outside Germany (Deutsche Bank, Annual Report 1993).⁶

Towards the end of the 20th century when new information technologies, deregulation and disintermediation profoundly changed the global economic structure, Deutsche Bank's diverse activities as a universal bank posed a major strategic challenge for management. The introduction of the Single European Market in 1993 was a prime example of market liberalisation and marked the decline of national borders as obstacles to economic activity.

Following the launch of the European Single Market, Deutsche Bank's corporate strategy was torn between its universal banking roots and its ambition to obtain more capital-market oriented transaction expertise to complement its existing services. Throughout the 1990s, Deutsche Bank expanded into the Anglo-American investment banking world, while facing challenges from domestic risks, which appeared highly clustered in a global context.

During the period analysed, three different CEOs headed the bank. Hilmar Kopper became Deutsche Bank's CEO following the assassination of Alfred Herrhausen in 1989 and remained at the top of the bank until 1997.⁷ In the German management tradition, Kopper was thereafter appointed chairman of the bank's supervisory board. Rolf-Ernst Breuer presided over the bank's management board from 1997 until 2002, when Swiss-born Josef Ackermann took over.

⁵ Available from: http://www.deutsche-bank.de/csr/en/history/7605_7631.html# (Deutsche Bank AG, undated) [Accessed 15 January 2005].

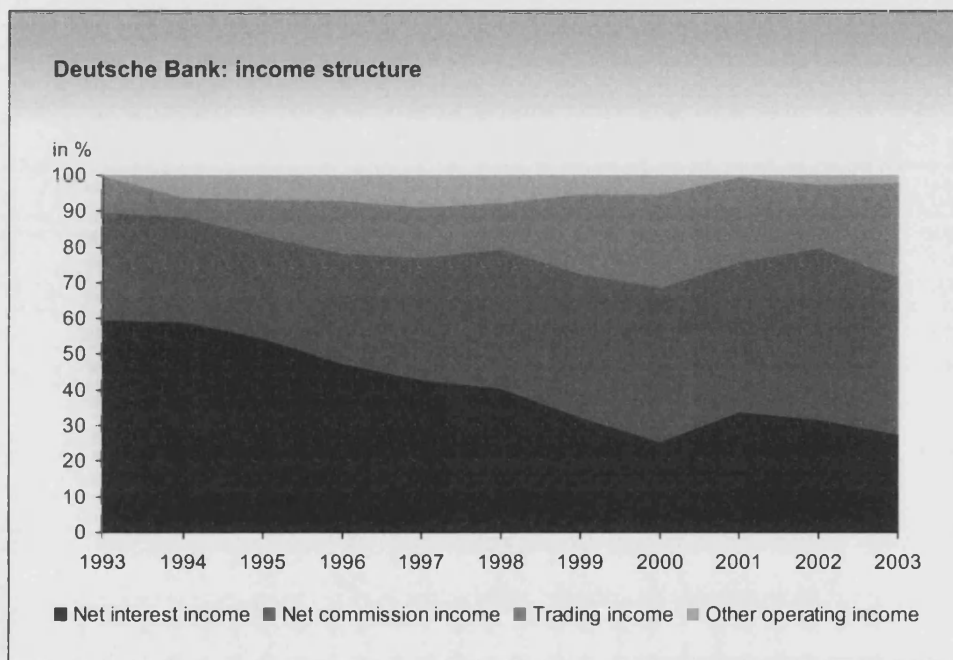
⁶ In 1993, the total number of branches was 2,431 with an all time high of 1,734 branches in Germany.

⁷ Former Deutsche Bank management board member F. Wilhelm Christians chaired the supervisory board from 1990 until 1997.

5.3.2. Income Structure

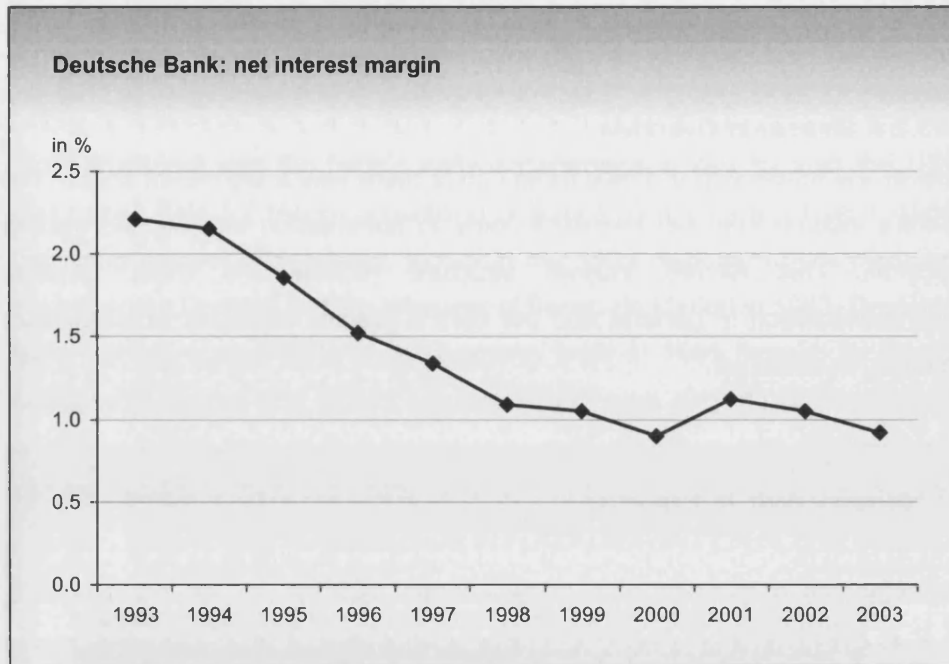
5.3.2.1. Structural Overview

Under the leadership of these three CEOs there was a significant shift in the bank's income from net interest income to commission income and trading income. This altered income structure reflects the trend towards disintermediation in general and the bank's greater exposure to investment banking in particular.



The group's interest income declined faster than its interest expenses. Net interest income dropped on average by 0.2% p.a. and amounted to EUR 5.8 billion at the end of 2003. Deutsche Bank's fall in net interest income was accompanied by a drop in its net interest margin. As total loans rose from EUR 170 billion in 1993 to EUR 365 billion in 2000, but thereafter declined sharply to EUR 145 billion, the net interest margin deteriorated and stood at 0.92% in 2003, compared to 2.21% in 1993.⁸

⁸ Deutsche Bank changed its accounting standards two times: for 1993 on the basis of HGB (German accounting law), for 1994 until 1999 on the basis of IFRS (IAS) and for 2001, 2002 and 2003 on the basis of US GAAP.



While Deutsche Bank still generated 60% of its total operating income from net interest income⁹ in 1993, this figure had declined to 28% by 2003. During the same period the proportion of commission income rose from 30% to 44%. The income contribution from trading increased from 10% in 1993 to 27% in 2003. In absolute terms, Deutsche Bank's total operating income more than doubled from EUR 10.0 billion in 1993 to EUR 21.1 billion in 2003. This implies a compound annual growth rate of 7.8%.

Besides operating income, Deutsche Bank's non-operating income played a major role during the period analysed. The group's non-operating income primarily resulted from the continuous sale of its large industrial holdings, which it had built up over a century. According to Deutsche Bank's 1993 annual report, the bank held stakes of at least 10% in 25 listed German companies. The total market value of these investments was EUR 13 billion (Deutsche Bank, Annual Report 1993). At the end of 2003, the group's industrial holdings amounted to EUR 10 billion (Deutsche Bank, Annual Report 2003, p. 39).

Deutsche Bank boosted its net profit through average non-operating income of EUR 1 billion p.a. (net income from investments). The positive effect of the

divestment of its stakes in German industrial companies on pre-tax ROE was on average 4.7 percentage points. Selling the German investments contributed to a diversification of its asset base and bolstered the turbulent transition process the bank was undergoing during the decade analysed.

The strategic measures that led to an expansion of the group's investment banking business will be reviewed first as they were behind the general shift from transformation to transaction services (interview Hilmar Kopper). Subsequently, this case study will concentrate on Deutsche Bank's asset management activities, which also contributed to that shift. The different types of asset management clients, i.e. retail and institutional clients, make this business a point of intersection between investment banking and retail banking. The consequences of Deutsche Bank's corporate strategy for its retail banking operations will complete the analysis of the bank's income structure.

⁹ Net interest income is the difference between gross interest income (from the bank's assets) and interest expense (from the bank's liabilities), i.e. the cost of funds.

5.3.2.2. Corporate and Investment Banking

This research uses the term investment banking in its broad sense and not just as a synonym for mergers and acquisitions (M&A) advisory activities. According to Deutsche Bank's glossary, investment banking is a generic term for capital market-oriented business. This includes primarily the issuing and trading of securities and their derivatives, interest and currency management, corporate finance, M&A advisory, structured finance and private equity (Deutsche Bank, Annual Report 2002, p. 257).

When Germany's largest bank expanded into international investment banking, it had to come to terms with an industry-wide trend towards disintermediation, its low market share in domestic retail banking, and an internationally active corporate client base (interview Hilmar Kopper). Two major acquisitions determined Deutsche Bank's strategic positioning within the Anglo-American investment banking world.

The first leap forward was the bank's GBP 950 million acquisition of UK merchant bank Morgan Grenfell in 1989 (completed in 1990). Notwithstanding the acquisition of Morgan Grenfell, Kopper considered that Deutsche Bank was still underrepresented in shares and derivative products (Simonian, FT, 16 September 1993). He remarked in 1993 that Deutsche Bank did not enjoy the same international clout in equities as in bonds (Simonian, FT, 16 September 1993). Following this statement, Deutsche Bank boosted its equity business in the City of London and Kopper explicitly recognised London, not Frankfurt, as the bank's base for European equities business (Denton, Cohen & Parkes, FT, 26 September 1994).

For the first five years after its acquisition, Morgan Grenfell enjoyed a high degree of autonomy and operated as a separate business unit. Finally, in 1995 Deutsche Bank brought all of its international investment banking activities together in London under the umbrella of Morgan Grenfell which it renamed Deutsche Morgan Grenfell (Deutsche Bank, Annual Report 1995, pp. 19-25). This new group division comprised seven businesses¹⁰ and employed 7,000 people in 40 countries (Deutsche Bank, Annual Report 1995, pp. 19-25). Between 1994 and 1996 Deutsche Bank stepped up its investment

¹⁰ Deutsche Morgan Grenfell's seven businesses were: Global Markets, Equities, Investment Banking, Structured Finance, Emerging Markets, Asset Management, Development Capital.

banking operations, spending in total an estimated DM 2.8 billion (Fisher & Denton, FT, 29 March 1996).

While Morgan Grenfell helped improve Deutsche Bank's standing in London, the deal had little bearing on its US exposure. For most of the 1990s, Deutsche Bank pursued an organic growth strategy in the US. This relied heavily on poaching staff from other investment banks.¹¹ An exception to the organic growth strategy in the US was the acquisition of ITT's commercial finance unit for USD 2.6 billion in 1995, which became the heart of the commercial inventory financing businesses, Deutsche Financial Services.¹² Deutsche Financial Services was sold in October 2002 for USD 2.9 billion, as part of Ackermann's overhaul of the bank's core competences.

By acquiring the US investment bank Bankers Trust for USD 10.1 billion in November 1998 (completed in 1999), Deutsche Bank abandoned its organic growth strategy in the US investment banking sector (Lewis & Corrigan, FT, 23 November 1998 & Barber, FT, 1 December 1998). The acquisition of Bankers Trust with its 20,000 employees enabled Deutsche Bank to expand its presence in the US investment banking market while reducing costs by eliminating duplication of work. As a result some 5,500 jobs were cut, mostly in London and New York (Andrews, New York Times, 1 December 1998).

During the 1990s, Bankers Trust had built up expertise as an originator of high-yield bonds and a derivatives house. Bankers Trust's trading exposure showed up in a rise in Deutsche Bank's trading income in 1999. Shortly before Bankers Trust was taken over it had itself acquired three firms, namely the securities broker Alex. Brown, M&A boutique James D. Wolfensohn, and parts¹³ of NatWest Markets (Dries, Börsen-Zeitung, 24 November 1998; Peterson & Silverman, Business Week, 7 December 1998; Ewing et al., Business Week, 19 July 1999).

Not least through James D. Wolfensohn, Bankers Trust initially helped boost Deutsche Bank's expertise in the M&A advisory business for MBOs

¹¹ Deutsche Bank's aggressive hiring spree led to tension with other banks and even prompted ING's CEO Hessel Lindenbergh to make a formal complaint to Hilmar Kopper. Ultimately, a case was filed with the New York Supreme Court (Denton, FT, 6 June 1996 & Denton, FT, 8 June 1996).

¹² This business was located in Saint Louis, Missouri, USA.

¹³ Equities research, institutional sales and trading, and primary markets origination business in the UK and Europe.

(management buy-outs) and LBOs (leverage buy-outs). The Bankers Trust acquisition strengthened Deutsche Bank's product expertise (Deutsche Bank, Annual Report 1998), but did not provide a significant distribution network. This view is also shared by a former aide¹⁴ of Deutsche Bank's CEO Breuer, who said that the deal was aimed at attaining US capital market expertise, but not distribution (interview Alexander Hiller).

The acquisition of Bankers Trust illustrates how actual strategy may deviate from the previously communicated strategy. Only few months before the deal, Frank Newman, CEO of Bankers Trust, made clear in an interview that "Bankers Trust is not for sale" (Lewis, FT, 30 December 1997). However, altered circumstances¹⁵ changed his mind. Moreover, the Bankers Trust deal did not simply contrast with what Newman had said, it was also inconsistent with Kopper's previous statements on Deutsche Bank's US strategy.

Shortly before Kopper stepped down as CEO in May 1997 to assume the chairmanship of the supervisory board, he unambiguously ruled out a major acquisition in the USA and was quoted as saying "there is no question at all of us doing that. That would be the stupidest thing we could do today. We are trying to [expand] in America from our own resources. The stupidest thing we could do at this time would be to pay a lot of money when the market is in a growth phase" (Fisher, FT, 13 May 1997). Just a few weeks later Kopper's organic growth strategy for the US was reiterated by the bank's new CEO Breuer (FAZ, 24 July 1997).

However, in the interview for this case study Hilmar Kopper pointed out that by the end of 1998 it had become clear that the Glass-Steagall Act would soon be repealed by the Gramm-Leach-Bliley Act (November 1999), allowing commercial and investment banks to merge. In fact, throughout the 1990s the interpretation of the Glass-Steagall Act had been softened and some US financial institutions even anticipated the Gramm-Leach-Bliley Act. The most famous instance was the creation of Citigroup in April 1998. Deutsche Bank's management realised that these legal and regulatory changes opened up unprecedented opportunities and that they should swiftly try to break into the US investment banking market. According to Hilmar Kopper it is not possible

¹⁴ Conversation with Alexander Hiller, Deutsche Bank, Thursday, 24 March 2005.

¹⁵ The 1998 financial crises in Asia and Russia reduced Bankers Trust's profitability.

to become a leading investment bank without being global and being global inevitably means being strong on the US capital markets (interview Hilmar Kopper).

5.3.2.3. Asset Management

Deutsche Bank's expansion into investment banking also contributed to the growth in its asset management activities. The acquisition of Morgan Grenfell and Bankers Trust boosted assets under management and helped Deutsche Bank gain expertise in dealing with equities (interview Hilmar Kopper).¹⁶ Although Morgan Grenfell was acquired back in 1989, the developments at Morgan Grenfell Asset Management (MGAM) had far-reaching implications for Deutsche Bank's corporate strategy in the 1990s.

The most prominent of these were the fraudulent investments by a fund manager, which became public in September 1996 when three Morgan Grenfell investment funds (unit trusts) had to be suspended. Deutsche Bank indicated in March of the following year that the failure of its UK fund management arm could cost up to DM 1.2 billion (GBP 450 million) (Fischer, FT, 27 March 1997). In its annual report for 1996, Deutsche Bank explained that this fund affair had led to a "major review of the division's management structure and control system" (Deutsche Bank, Annual Report 1996, p. 30).

It is only possible to speculate whether these fraudulent activities would have been of the same magnitude if Deutsche Bank had fully integrated Morgan Grenfell at an earlier stage, rather than some five years after its acquisition. However, it appears that Deutsche Bank's management emphasised rapid integration of Bankers Trust because of its UK experience. On the day on which the Bankers Trust deal was announced, Breuer explained at a news conference "We don't believe in autonomy as an instrument of management and leadership [...] As far as it goes, we want a centralized management of the business" (Andrews, New York Times, 1 December 1998). This statement suggests that Deutsche Bank's management was determined to integrate Bankers Trust into the bank's existing business quickly and completely.¹⁷

Bankers Trust, which at the time of the deal was the eighth largest bank in the United States, increased assets under management at Deutsche Bank by EUR 250 billion. Although most of these were low-margin passive management accounts, Deutsche Bank emerged as the world's fourth largest

¹⁶ Morgan Grenfell brought GBP 43 billion of assets under management to Deutsche Bank, which had had a total assets under management of DM 73 billion (approx. GBP 25 billion) before the deal (Lascelles, FT, 28 November 1989).

asset manager (up from number fourteen) as a result of the Bankers Trust acquisition (Roth, FAZ, 31 October 2000). Subsequently, Deutsche Bank decided to group its asset management operations in a single worldwide business known as Deutsche Asset Management.

The growth in Deutsche Bank's asset management business also made it one of the largest players in the custody¹⁸ business. In 2002, Deutsche Bank had assets under custody of EUR 2.2 trillion worldwide and 3,200 employees in this division. However, the stable but low-margin custody business was identified as a non-core operation by Ackermann and put up for sale in 2002. The bank announced the divestment of its custody business for USD 1.5 billion in November 2002. Only three months later Ackermann also sold most of Deutsche Bank's global passive asset management business to Northern Trust Corporation (Deutsche Bank, Annual Report 2002, p. 40; Börsen-Zeitung, 4 February 2003).¹⁹

In its 2002 annual report, Deutsche Bank made it clear that its focus in asset management would be on "active institutional, retail and alternative investments" (Deutsche Bank, Annual Report 2002, p. 40). The acquisition of Scudder Investment from Zurich Financial Services Group (ZFS) in 2001 thus appeared consistent with its strategy. The deal added USD 250 billion of actively managed assets to Deutsche Bank's assets under management. As part of the USD 2.5 billion deal, Deutsche Bank essentially exited its life insurance operations as ZFS received 76% of the life insurance company Deutscher Herold. Deutsche Bank and ZFS signed a mutual distribution agreement under which Deutsche Bank would continue to distribute life assurance products for Zurich's enlarged German operations, while ZFS would continue to sell Scudder products across Europe (Clow & Wine, FT, 26 September 2001; Börsen-Zeitung, 6 April 2002).

¹⁷ Further evidence of the intended rapid integration can be found in the group's 1998 annual report (Deutsche Bank, Annual Report 1998, p. 27).

¹⁸ Custodians serve as a sort of safe house for securities bought by investment managers. A custodian arranges to take possession of bonds, equities, currency or other securities when their clients trade in such instruments. Other services offered by custodians to institutional investors comprise compiling and reporting data on the investment's price, value and progress. Custody business is a low-margin business that benefits from economies of scale. During the 1990s the global custody business underwent rapid consolidation (Bowe, FT, 14 July 2000).

¹⁹ The price ranged between USD 144 million and USD 161 million (Börsen-Zeitung, 4 February 2003).

5.3.2.4. Retail Banking

The disposal of Deutscher Herold brought Deutsche Bank's own retail insurance activities to an end. The bank's foray into the insurance sector had started in 1989 when it began selling its own life insurance policies through its branches. The bank's insurance operations were advanced in 1992 by acquiring a 30% stake in industrial insurer Gerling Insurance for an estimated DM 1.5-2.0 billion (Waller, FT, 11 July 1992) and a stake in the Deutscher Herold insurance group.

In 1998, Breuer publicly reviewed the bank's strategic insurance options in an interview (Fisher & Clay, FT, 9 February 1998). He considered Deutsche Bank's insurance arm to be unsatisfactory and suggested that the options were either to increase it to a reasonable size or "to get rid of it" (Fisher & Clay, FT, 9 February 1998). He also pointed out that if Deutsche Bank were to remain in the insurance business these operations would have to be expanded to European level (Fisher & Clay, FT, 9 February 1998). A few months later Breuer explained that there had been a shift in Deutsche Bank's strategy regarding insurance. Deutsche Bank had concluded it did not need its own insurance group and would not be interested in acquiring an insurance company. He was quoted as saying, "we are now convinced that it is not necessary for a universal bank to produce insurance products itself, but that it needs to distribute them" (Bowley, FT, 28 July 1998).

Although it announced its intention of withdrawing from insurance in 1998, Deutsche Bank had not entirely abandoned its insurance business even after the aforementioned "swap" with ZFS in 2001. Deutsche Bank still owned the 30% stake in industrial insurer Gerling. Following the terrorist attacks on 11 September 2001, Gerling's reinsurance subsidiary accrued a loss of EUR 500 million in 2001. This necessitated a EUR 300 million capital injection in March 2002. As a result, Deutsche Bank's investment actually increased to 34.5% (Fromme, FT, 15 March 2002). Subsequently, Deutsche Bank had to write down EUR 500 million related to Gerling in April 2003 (Jenkins, FT, 25 April 2003) and eventually returned its stake to majority shareholder Rolf Gerling for free (Fromme & Jenkins, FT, 30 April 2003).

While Deutsche Bank's excursion into bancassurance was a cornerstone of its retail banking strategy during the first half of the period analysed, in the

second half the focus shifted towards the use of new technologies and the bank's European businesses (interview Hilmar Kopper). At the hub of the group's pan-European retail banking strategy was Deutsche Bank 24, which was set up in September 1999 when Deutsche Bank hived off most of its German retail banking operations following a review of its retail client segmentation (Grant, FT, 1 September 1999). Equipped with a new logo, Deutsche Bank 24 was promoted as a separate brand for the mass retail banking market. This re-branding sharpened the distinction between Deutsche Bank's remaining clients, who were defined as high-net-worth private banking clients, and the second-tier Deutsche Bank 24 clients.

As part of the Deutsche Bank 24 strategy a European-wide retail banking platform and online brokerage service were launched in August 2000. This targeted seven European countries: Germany, Italy, Spain, France, Portugal, Belgium and Poland. Deutsche Bank expected Deutsche Bank 24's operating profits to rise from EUR 400 million in 2000 to EUR 1 billion by 2004 (Roth, FAZ, 4 August 2000). However, this profit target never materialised, not least because shortly after his appointment as the group's CEO in 2002, Josef Ackermann instituted an organisational shake-up of the private client business that included the reintegration of Deutsche Bank 24 into Deutsche Bank.

Deutsche Bank's grand European retail banking strategy was meant to be built on its established retail operations in Italy and Spain, which had already reached a substantial size by the late 1980s. Deutsche Bank began to expand in Italy through the USD 600 million (DM 1.2 billion) acquisition of Banca d'America e d'Italia in 1986. Three years later Deutsche Bank bought a majority stake in Spain's Banco Comercial Transatlantico (BCT) and advanced its Spanish operations through the takeover of Banco de Madrid for ESP 42 billion (USD 357 million) in 1993. Following this transaction Deutsche Bank had assets of DM 16 billion²⁰ (USD 9.6 billion), 318 branches and 3,000 employees in Spain (Deutsche Bank, Annual Report 1994).

In 1993 Deutsche Bank's CEO Kopper said that the bank was content with its European retail banking network and that there were no acquisition plans for France and the UK. However, he did consider expanding further into Italy by acquiring small regional banks (Simonian, 1993, FT, 16 September 1993). In

November of the same year, Deutsche Bank acquired 58% of Banca Popolare di Lecco (BPL), for ITL 470 billion (USD 277 million; DM 470 million). This small northern regional bank had 1,200 employees and 100 branches in Lombardy (FAZ, 25 November 1993).

While Deutsche Bank made inroads into the Spanish and Italian retail banking markets, its attempts to enter the French market were less successful. Breuer, who speaks fluent French, seemed much more committed to entering the French market than his predecessor Kopper. In July 1997 Breuer expressed his interest in boosting Deutsche Bank's distribution network in the French market (FAZ, 24 July 1997).

However, he saw his plans to buy a large French bank thwarted when German insurer Allianz took a majority stake in the French insurer AGF in 1998. At the time Breuer explained that "the feeling in France, if I'm not totally mistaken, is that it is now the turn of a French institution to [take over] a German one," and he added: "Reciprocity is what they call it, and as long as that is the name of the game, I think Deutsche Bank does not have much of a chance for a major acquisition in France" (Fisher & Harris, FT, 9 February 1998).

Breuer said Deutsche Bank would always go for a friendly takeover as the bank would need the support of the local management and they needed the support of the French authorities (Fisher & Harris, FT, 9 February 1998). In fact, Hilmar Kopper conceded in the interview for this case study that he would have liked to enter the French banking market but had to acknowledge that the role of the state in the banking market was too strong (interview Hilmar Kopper).

Subsequently, Deutsche Bank tried to expand organically in France and built a multi-channel distribution network targeting affluent clients. In 2000, Deutsche Bank sold its products through around ten branches and via the internet with additional support from call centres (FAZ, 2 August 2000). In early 2001, Deutsche Bank acquired the core activities of Banque Worms from AXA (Börsen-Zeitung, 20 March 2001). Only few months later, in December 2002, Deutsche Bank sold its French retail operations with its 11,000 clients to the

²⁰ DM 3.1 billion were added by acquiring Banco de Madrid (Deutsche Bank, Annual Report 1993, p. 46).

Dutch bancassurance group ING and therefore effectively withdrew from the French retail banking market.²¹

Other major European retail banking acquisitions were the 1998 expansion into the Belgian market through the DM 1 billion (USD 596 million) takeover of the Belgium business of Credit Lyonnais. In the same year, Deutsche Bank acquired 9.3% of Greece's third largest bank, EFG Eurobank Ergasias, which it sold again in November 2003.

During the period analysed Deutsche Bank only undertook two substantial strategic transactions in retail banking outside Europe. In 1997 it sold its Argentinean retail banking operations with some 100,000 clients to BankBoston for USD 250 million (Börsen-Zeitung, 30 September 1997) and in 2000, at the height of the dotcom boom, it bought National Discount Brokers, a US market maker and online broker, for about USD 1 billion²² (Börsen-Zeitung, 13 October 2000). Less than a year later, in July 2001, Deutsche Bank sold National Discount Brokers Corp., but it kept the market maker arm.

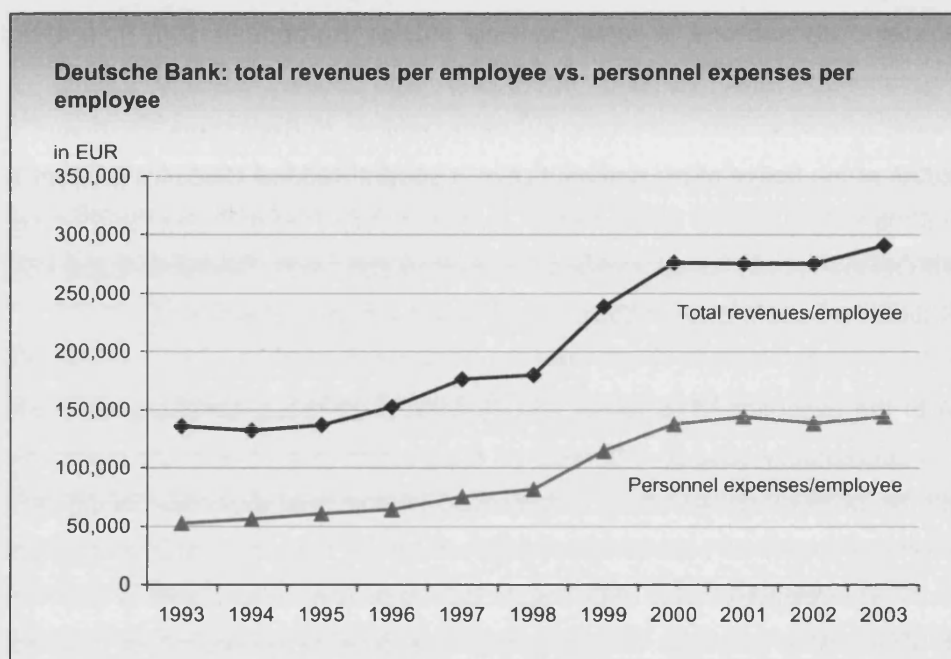
With the exception of its Italian and Spanish businesses, Deutsche Bank did not successfully build an international retail organisation that could match the growth of its other operations. Imbalanced international expansion of different business areas has substantial implications for the risk structure of a universal bank. The relative decline of Deutsche Bank's retail banking activities deprived it of a stable earnings component and a predictable source of funding. Effectively, Deutsche Bank failed to reproduce its universal banking model on an international scale.

²¹ Deutsche Bank kept its Paris branch and Banque Worms (Börsen-Zeitung, 10. January 2002). Banque Worms was liquidated by Deutsche Bank in 2004 (Börsen-Zeitung, 4 June 2004).

²² At the time of this deal, the online brokerage arm had some 268,900 customer accounts and USD 11.2 billion in customer assets (Börsen-Zeitung, 13 October 2000).

5.3.3. Cost and Risk Management

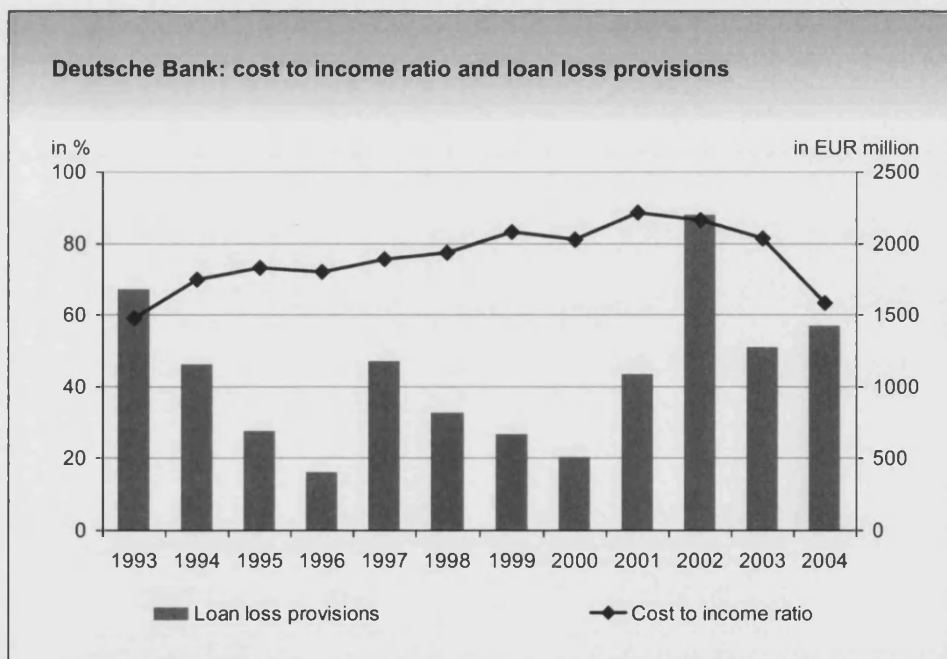
Deutsche Bank's character as a universal bank is also reflected in the group's expenses. Throughout the period analysed, two issues dominated cost and risk management at the bank. First, its internationalisation was primarily driven by expansion into investment banking, which is shown by the rise in personnel expenses per employee. Second, its exposure to German industry was increasingly perceived as a cluster risk, especially given the liberalisation of the European market and the group's increasing internationalisation.



Deutsche Bank's investment banking strategy entailed internationalisation of its operations, giving it a greater presence in the capital market hubs, London and New York (interview Hilmar Kopper). The competitive investment banking environment contributed to a continuous rise in personnel expenses between 1993 and 2003. In particular, the entry into the US investment banking market increased personnel expenses per employee by 40% (year-on-year) in 1999, and a further rise of 20% in the following year. However, total operating income per employee only increased by 33% (year-on-year) in 1999 and 16% in 2000 (year-on-year), implying an erosion of the group's profitability. This pattern also holds true for the whole period between 1993 and 2003. While the costs per employee increased by an average of 10.7% p.a., i.e. from EUR

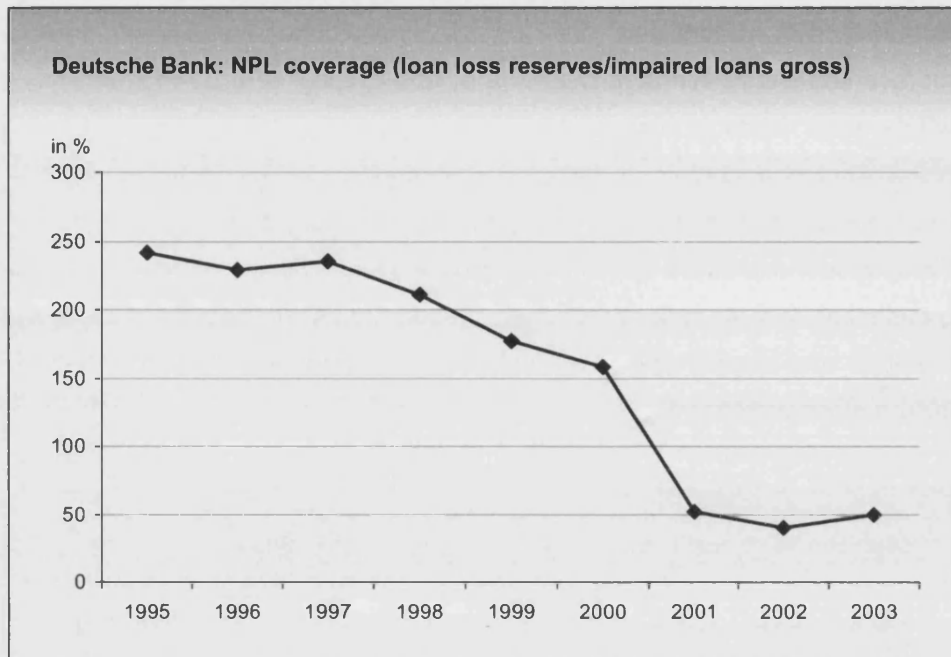
52,505 in 1993 to EUR 144,635 in 2003, total operating income per employee increased by an average of just 8% p.a.

Although Deutsche Bank grew its total operating income at an annual rate of 7.8% (CAGR 1993-2003), it employed nearly 5,500 fewer people at the end of 2003 than in 1993. This development was not only due to rapid technological progress and improved efficiency, it also mirrors Deutsche Bank's changed business mix. Effectively, the bank's move into investment banking represented a shift from employees who generate low revenues to employees whose work leads to high revenues. However, since personnel costs rose faster than revenues per employee and there were few scale efficiencies, Deutsche Bank's cost income ratio deteriorated during the period analysed. In 1998, Breuer expressed concern at the bank's high cost levels, saying that the group's cost income ratio of 76% was unsatisfactory. He said the bank aimed to cut its cost income ratio to 65% in four years (Fisher, FT, 3 April 1998). In 2002 it stood at 86%.



Another decisive cost/risk factor is a bank's loan loss provisioning, which is not included in the cost income ratio. Deutsche Bank's loan loss provisions declined between 1993 and 2003 as it reduced its loan portfolio. However, problem loans did not decline by the same amount, as reflected in a reduction

in Deutsche Bank's coverage ratio (loan loss reserves relative to problem loans; see diagram). The decline was particularly sharp after Deutsche Bank's switch to US accounting standards (US GAAP), which was necessary for its listing on the New York Stock Exchange in 2001. Moreover, even without the change to US GAAP, the group's coverage ratio had deteriorated steadily between 1995²³ and 2000.



The relatively high asset exposure in Germany was exacerbated by Deutsche Bank's industrial holdings, which had been built up over a century as the main banking partner ("Hausbank") to many large German companies. In 1993, Deutsche Bank disclosed its industrial holdings for the first time. These included a 28% stake in Daimler Benz (DM 11 billion on 31 December 1993). According to Deutsche Bank's 1993 annual report, the bank held stakes of at least 10% in 25 listed German companies.²⁴ The total market value of these investments was DM 25 billion (EUR 13 billion) at the end of 1993 (Deutsche Bank, Annual Report 1993). Given the geographic concentration of these holdings and their value, which exceeded Deutsche Bank's shareholders' equity of DM 21 billion at the time, they represented a cluster risk.

²³ Deutsche Bank did not disclose its "problem loans" before 1995.

²⁴ The three largest unlisted companies included the aforementioned 30% investment in Gerling insurance.

The more international Deutsche Bank's operating business became, the greater the cluster risks associated with its exposure to German industry appeared to be. The internationalisation of the bank's revenues was not accompanied by corresponding international diversification of its assets. While Deutsche Bank could use the gradual disposal of its investments to boost its earnings, write-downs and rescue packages for some of these holdings also held back profitability. Among the more prominent rescue operations in which Deutsche Bank played a leading role were, for example, Metallgesellschaft, Klöckner-Humboldt-Deutz and Holzmann.

Metallgesellschaft (now renamed in MG Technologies), a metals, mining and industrial group, was Germany's fourteenth largest industrial company when it faced severe liquidity problems at the end of 1993. As a result of its oil trading activities in the United States, it suddenly found itself on the verge of bankruptcy. Metallgesellschaft turned to its largest creditor, Deutsche Bank, for help. Deutsche Bank, which also owned 10% of the company, provided an undisclosed liquidity injection and subsequently headed the consortium of creditors. The rescue package comprised DM 2.5 billion of fresh equity and DM 700 million²⁵ of additional debt (FAZ, 5 December 1994).

Further examples were Deutsche Bank's DM 550 million bailout of the Klöckner-Humboldt-Deutz industrial group²⁶ in June 1995 and the near-bankruptcy of the construction group Holzmann in 1999. Due to some property deals, Holzmann was on the brink of collapse with an expected loss of DM 2.4 billion (Major, FT, 19 November 1999; FAZ, 19 November 1999). Again, Deutsche Bank, as Holzmann's "Hausbank" did not merely own 15% of the company; it was also one of its largest creditors, with outstanding loans of almost DM 2.2 billion (Major, FT, 19 November 1999; FAZ, 19 November 1999). Despite a DM 3 billion reorganisation plan, including a DM 250 million²⁷ government subsidy, Holzmann filed for bankruptcy in 2002 and was gradually liquidated (FAZ, 9 May 2001; Hargreaves, FT, 9 May 2001; Börsen-Zeitung, 30 September 2004).

²⁵ Of the DM 700 million debt, DM 300 million was provided jointly by Deutsche Bank and Dresdner Bank.

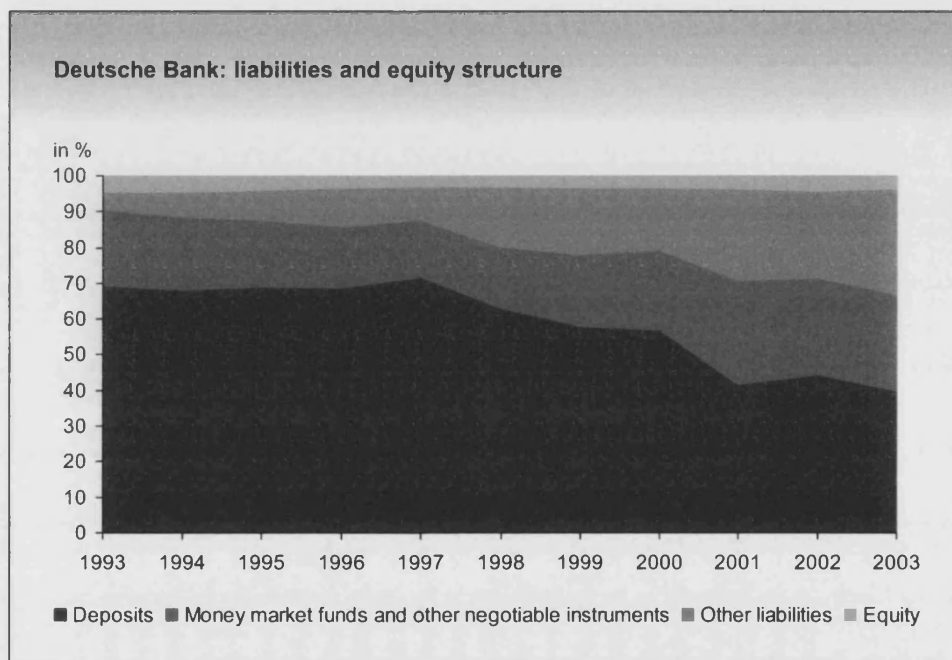
²⁶ Due to these capital measures Deutsche Bank's investment in the company increased to around 47%, up from 31% beforehand.

²⁷ This DM 250 million government subsidy consisted of a DM 150 million loan from a state bank and DM 100 million of deficiency suretyship from the government.

A capital gains tax of 50% did not provide any real incentive for Deutsche Bank to dispose of its industrial holdings in Germany. Breuer expressed his dissatisfaction about Deutsche Bank's industrial holdings in an interview in 1998. He was quoted as saying that the bank's industrial holdings were wholly German and that the pace of disposals was limited by the tax rate on capital gains (Fischer & Clay, FT, 11 February 1998). However, in anticipation of the abolition of the capital gains tax, Deutsche Bank found a way of arranging the disposals so that the profits could be booked later and would not incur capital gains tax. Therefore, Deutsche Bank had already sold off some of its stakes by 2000 when the German government decided to abolish capital gains tax with effect from 1 January 2002.

5.3.4. Asset-Liability Structure

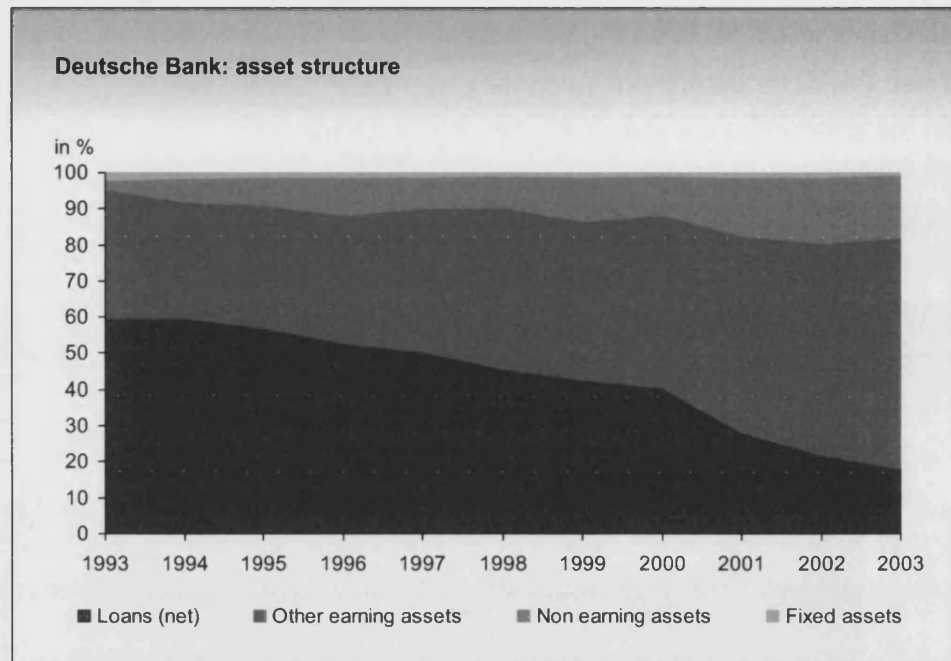
The relatively high concentration of assets in Germany in the form of loans and direct investments was reduced somewhat by the acquisition of Bankers Trust. Deutsche Bank's expansion into investment banking also left its mark on the structure of the group's funding (i.e. liabilities and equity). Throughout the period analysed, the proportion of deposits (from customers and other banks) declined relative to total liabilities.



While the equity ratio remained stable 3-4% of total liabilities, other liabilities increased strongly from 5% in 1993 to 29% in 2003. These "other liabilities" largely comprised trading liabilities such as the negative market values of derivative financial instruments. In the same vein, Deutsche Bank's trading assets tied up 36% of its total assets at the end of 2003, in contrast to just 4% in 1994. Trading liabilities and trading assets rose due to increased trading in capital market instruments.

The bank's shift towards transaction services also reduced the ratio of net loans to deposits from 87% (1993) to 45% (2003). This ratio measures the group's overall liquidity as it indicates the extent to which depositors' funds are

tied up in lending (Golin, 2001, p. 328). Deutsche Bank's increased capital market exposure effectively led to an improved liquidity profile.

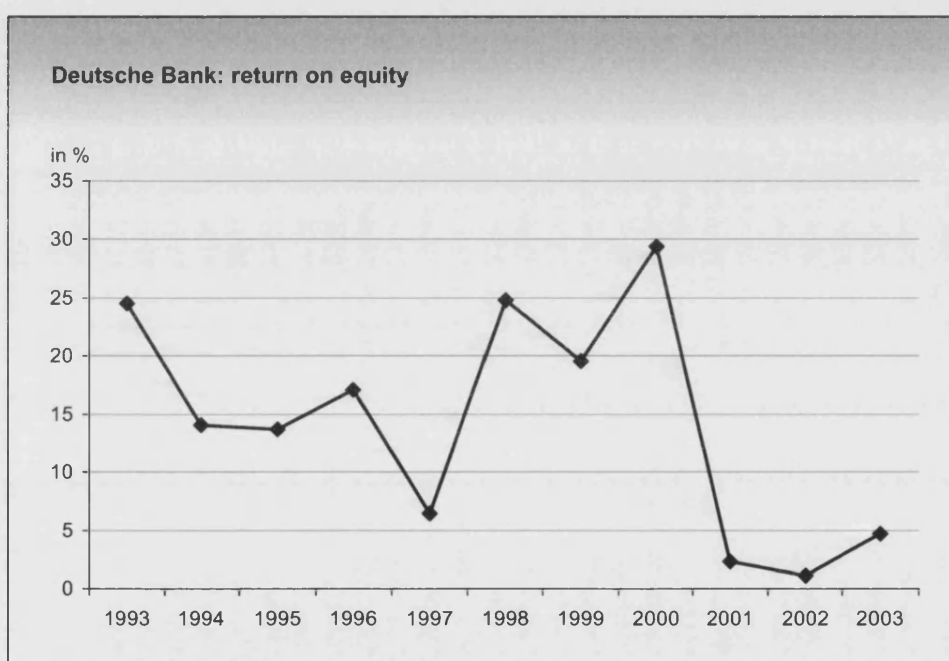


An additional consequence of the bank's reduced loan portfolio is reflected in its rising tier 1 ratio. At the end of 2001, the tier 1 ratio exceeded the group's target core capital ratio of 8%. Scaling back risk-weighted assets relative to shareholders' equity left Deutsche Bank so well capitalised that Ackermann launched a share buy-back programme in 2002. Deutsche Bank's management decided to fund this out of capital gains from the sale of the bank's industrial holdings. The main purpose²⁸ of the share buy-back programme was to reduce shareholders' equity and therefore enhance the return on equity and earnings per share.

²⁸ Ackermann also tried to use this to support Deutsche Bank's share price. He was quoted as saying: "Given our current share price level we are convinced that buying back our own stock is an attractive alternative to other investments" (Deutsche Bank, Press Release, 26 June 2002).

5.3.5. Profitability

Transaction services, as typically provided by investment banks, require less regulatory capital than transformation activities. Thus, investment banks should generally have higher ROEs than commercial and retail banks. Yet, Deutsche Bank's expansion into investment banking did not lead to a substantial rise in the group's ROE. Although Deutsche Bank's profitability benefited from the disposal of its industrial holdings, in most years its ROE before tax was only 14% on average.



Deutsche Bank's after tax ROE averaged 7.4% between 1993 and 2003, which probably did not cover its undisclosed cost of equity. As outlined in the chapter on European Financial Markets a bank's cost of equity can be derived from the capital-asset pricing model (CAPM), which uses a beta factor. Since the beta factor measures share price movements relative to a market index, the volatility of a bank's profitability, insofar as it is reflected in the share price, should also influence its refinancing costs. Consequently, it may be concluded that the degree of profit volatility affects the level of profitability.²⁹

²⁹ Deutsche Bank's profit volatility mainly increased during the second half of the period analysed, which coincides with its expansion into investment banking. The bank's changed income structure was probably responsible for the higher earnings volatility. Deutsche Bank's relative annual change in earnings was more volatile than the relative change in total operating income. In quantitative terms, this can be expressed using standard deviation. The standard deviation of the group's earnings is 74 as opposed to 18 for operating

One reason for Deutsche Bank's mediocre profitability, in spite of its revenue growth, can be found in the previously highlighted erosion of its net interest margin. This deprived it of a stable source of income. There may be multiple reasons why a bank's net interest margin declines, including fiercer competition in the wake of deregulation, technological and financial innovation and management's difficulty in correctly anticipating changes in the yield curve.³⁰

An additional reason for Deutsche Bank's weak profitability can be ascribed to the fact that it went through a transition phase during which it reinvented itself as an investment bank. When Deutsche Bank abandoned its familiar home turf for the highly competitive global investment banking world, it embarked on a steep learning curve for which it had to pay its due.

For example, it faced such challenges as having to pay a premium for successful investment bankers to join Deutsche Bank from one of the US "bulge bracket" banks. Moreover, the group's profitability may have also suffered from a sense of disorientation among its employees during the phase of organisational realignment. Consequently, Deutsche Bank's moderate results should also be considered in the context of the transformation of its business model.

income. The greater earnings volatility could not be offset by a more flexible cost structure, which also explains the rise in the group's cost income ratio.

³⁰ The Bank for International Settlement also points out that changes in net interest margins can be a major uncertainty as regards the profitability of banks. Therefore, a bank should manage its exposure to volatility in the yield curve in ways that limit the effects on its net interest margin (Bank for International Settlement Quarterly Review, December 2002).

5.3.6. Conclusion

Deutsche Bank's management recognised towards the end of the 1980s that the greatest threat to the group was its exposure to the German economy (interview Hilmar Kopper). On the one hand, it had to deal with a cluster risk comprising large German companies, in which the bank owned significant stakes and to which it was a major lender. On the other hand, the fragmented German retail banking landscape, which was dominated by savings and cooperative banks, left, at least from Deutsche Bank's point of view, little room to improve the profitability of business with German retail and SME clients. The group's CEOs during the period analysed - Kopper, Breuer and Ackermann - believed that Deutsche Bank could not change the structure of the German retail banking market on its own and therefore had to make the best of this unfortunate state of affairs (interview Hilmar Kopper).

Against the background of this analysis and the threat of increased disintermediation coming from export-oriented German corporate clients, management decided to transform Deutsche Bank into an international investment banking group (interview Hilmar Kopper). They took the view, and possibly still do, that investment banking requires international presence. Deutsche Bank focused on gaining expertise in transaction services, as a result of which the proportion of non-interest income rose over time. The changed income structure, which includes a relative decline in net interest income and an accompanying rise in commission and trading income, is as much evidence of this process of transformation as the bank's greater international profile.³¹

Retail banking played only a subordinate role, notwithstanding all the efforts during the 1990s to build a pan-European retail network and the frequently changing focus on the domestic market. All of that was mere strategic noise, according to Hilmar Kopper. The transformation from a domestic commercial bank with a weak retail client base and the implicit need to refinance via an ever more efficient capital market made the majority of Deutsche Bank's

³¹ In 1993, around two-thirds of Deutsche Bank's business still came from its domestic market. At the end of 2003, it generated merely 29% of its net revenues (net of provisions for loan losses) in Germany, where it had 24% of its assets and employed 44% of its 67,682 employees (compared with 78% of the workforce in 1993). By 2003, two-thirds of the bank's revenues came from corporate and investment banking (Deutsche Bank, Annual Reports 1993 & 2003).

management believe that it should alter its business model fundamentally. All activities that did not aim at building an international investment bank were just “trials and tribulations” (interview Hilmar Kopper).

Deutsche Bank’s metamorphosis bore the risk of getting stuck halfway, without it achieving the status of an international investment bank, while losing ground with retail and SME clients in its home market. As conceded by Kopper, Deutsche Bank was lucky to have changed its business model at a time when the capital markets were relatively benign, otherwise the institution might not have mastered this transformation (interview Hilmar Kopper). Moreover, the bank’s continuous bolstering of profits through the sale of industrial holdings smoothed the process.

The bank’s three CEOs during this period also mirrored the transformation. First, there was the hands-on, non-academic and far-sighted Hilmar Kopper (1989-1997), who came from Deutsche Bank’s traditional corporate banking side. His successor, Rolf-Ernst Breuer (1997-2002), who had been in charge of the bank’s capital market activities in the 1980s, was something of an interim CEO. During Breuer’s time as CEO, Kopper remained at the helm of the supervisory board. Then, in 2000, it was announced that Josef Ackermann would succeed Rolf-Ernst Breuer in two years’ time. Finally, Ackermann, an archetypical investment banker, took over as CEO in 2002. Under the leadership of its first non-German CEO, the bank made a great leap forward in investment banking. Ackermann’s active capital management and consistent focus on transaction services led to a pre-tax ROE close to his target of 25% in 2005.³²

The developments at Deutsche Bank during the period analysed show a clear pattern, which suggests that the group pursued a coherent and consistent strategy. The bank’s strategy was based on management’s belief that it could not change the structure of its domestic playing field and that it effectively had to reduce its exposure to the German market. This strategic insight paired with the growing significance of disintermediation and the prospect of leveraging

³² The published pre-tax return on average equity was 24.3% in 2005 (Deutsche Bank, Annual Report 2005).

Deutsche Bank's longstanding relationship with large industrial firms paved the way for its shift towards investment banking.

5.4. HSBC Holdings plc

5.4.1. Introduction and Status Quo in 1993

HSBC, whose name is derived from The Hongkong and Shanghai Banking Corporation, only became a “British” bank in January 1993 after the acquisition of Midland Bank¹ in the previous year. As a condition for the approval of the takeover, the Bank of England asked HSBC’s management to transfer the group’s head office² from Hong Kong to London. This also showed HSBC’s management a way to leave Hong Kong ahead of the handover of the colony to the communist People’s Republic of China in July 1997. Although the Bank of England became the principal regulator for HSBC Holdings in 1993, all of its banking subsidiaries outside the UK continued to be regulated locally in their country of operation (HSBC Holding, 2003b).

The bank was founded in 1865 by Thomas Sutherland, a Scottish businessman in Hong Kong, to serve the growing demand for more sophisticated trade finance in the Asia Pacific³ region. According to the bank’s IPO prospectus, it would operate on “sound Scottish banking principles” but be rooted in the local community (King, et al 1987-91). The bank agreed with the British Treasury that it would not need a London head office and could still enjoy the privilege of issuing banknotes and holding government funds. Right from the beginning the bank’s commitment to local ownership and management allowed it to gain a competitive advantage in the region – a strategic characteristic that was taken up in its advertising tagline as the “world’s local bank” in 2002 (King, et al 1987-91; HSBC Holding, 2003b).

The bank was able to expand rapidly throughout the Asia-Pacific region and did not come up against serious competition until the early 20th century when Dutch and French banks became more dominant players in that part of the world. Achievements in government finance contributed to The Hongkong and Shanghai Banking Corporation’s growing international reputation. The bank’s internationalisation received new impetus after the Second World War when it

¹ Midland Bank’s first full year as a fully consolidated member of the HSBC group was in 1993 (HSBC, Annual Report 1993).

² HSBC Holdings was created in 1991 and its shares were listed in London and Hong Kong.

embarked on an acquisition-led growth strategy to reduce its focus on Hong Kong. Subsequently HSBC expanded further throughout Asia, into the Middle East and into America. For example, it bought the British Bank of the Middle East in 1959 and in 1980 it acquired a 51% stake in the US American Marine Midland Banks, which led to full ownership in 1987 (HSBC Holding, 2003b).

While HSBC has been present in Europe since it opened a London office in 1865, it did not generate substantial revenues anywhere in Europe until it acquired Midland Bank in 1992⁴ (HSBC Holding, 2003b). HSBC's first attempt to revive its European connection came in 1981 when it made a bid for the Royal Bank of Scotland, which was rebuffed by the UK Monopolies and Mergers Commission. Six years later HSBC bought a 14.9% interest⁵ in troubled Midland Bank, which it finally took over entirely in 1992, valuing Midland at GBP 3.9 billion (Marckus & Goddway, The Observer, 10 March 1991; King, et al 1987-91; HSBC Holding, 2003b). The acquisition of Midland Bank transformed HSBC's representation in Europe and paved the way for the bank's rapid internationalisation during the 1990s.

When HSBC bought Midland, Midland was in the midst of a rescue operation, which had started in 1987. The bank was founded in Birmingham in 1836 by Charles Geach, a former employee of the Bank of England. He set up the bank to serve merchants and manufacturers in the Birmingham area (the Midlands) during the vibrant period of the Industrial Revolution (Holmes & Green, 1986). The bank specialised in discounting bills of exchange and rapidly expanded at the turn of the century under the leadership of Edward Holden.

Holden⁶ acquired several banks in England and pursued an acquisition-led growth strategy on a national level similar to the international growth strategy adopted by HSBC a few decades later. As a result, Midland Bank was the world's largest bank for some years during the 1920s (Holmes & Green, 1986). Despite this rapid growth, it remained deeply rooted in the Midlands and the countryside and remained relatively provincial (Holmes & Green,

³ Another contemporary large Western financial institution that was founded in China by non-Chinese is American International Group (AIG). AIG is one of the largest insurance companies in the world and was established in Shanghai in 1919 (BusinessWeek – online, 15 September 2003).

⁴ Midland Bank's first full year as a member of the HSBC group was in 1993.

⁵ HSBC paid GBP 383 million for this investment (Marckus & Goddway, The Observer, 10 March 1991).

1986). Midland Bank had high exposure to the traditional heavy industries in the north-west of England (Holmes & Green, 1986; Rogers, 1999) and lost momentum with the Great Depression in the 1930s. The bank continuously lost ground after the Second World War.

Unlike its British competitors, Midland remained rather coy about international expansion throughout the 1970s (Holmes & Green, 1986; Rogers, 1999). However, at the beginning of the 1980s it launched a frenetic internationalisation strategy.⁷ First it bought a controlling interest in the German private bank Trinkaus & Burkhardt in 1980. This is still the nucleus of HSBC's German operations (HSBC Holding, 2003b). In 1981 Midland acquired a majority stake in Crocker National of California. It turned out that Crocker's loan portfolio was burdened with more problem loans⁸ than initially expected. Although Midland was able to sell Crocker to Wells Fargo in 1986, an estimated USD 3.7 billion of Crocker's bad loans remained with Midland Bank, further depressing the bank's profitability in the following years (Rogers, 1999; Taylor, 1993).

The Crocker episode depleted the bank's capital to such an extent that the Bank of England had to intervene and appointed its Deputy Governor, Kit McMahon, to restore Midland in 1987. Under McMahon new technologies were introduced and Midland launched the UK's first 24-hour telephone bank, First Direct, in 1989 (Rogers, 1999). McMahon developed a relationship with HSBC, which bought a 14.9% stake in Midland during his time as Midland's CEO.

Despite all his efforts to restore Midland, his former employer, the Bank of England, effectively ousted McMahon in 1991 (Rogers, 1999). The Bank of England summoned Barclays' CFO Brian Pearse and according to his own account he was advised to accept the post as Midland Bank's CEO (Willcock, *The Guardian*, 25 March 1991; Rogers, 1999). Only some two years later, in November 1993, Pearse resigned from Midland Bank as he could not pursue his strategy and did not deliver the cost cuts expected by HSBC. So, the new

⁶ Edward Holden was Managing Director from 1898 to 1908 and Chairman and Managing Director from 1908 until 1919.

⁷ In 1984 Midland also hired a team of continental Europeans to expand internationally. Herve de Carmoy who joined Midland from Chase headed the team.

⁸ These problem loans were mainly to LDC countries and to commercial real estate developers.

owner put its own management in place and the bank became an integral part of HSBC group (FT, 6 April 1994).

In January 1993 John Bond, HSBC's new CEO arrived in London (AFX News, 2 November 1992). He had joined the bank in 1961 and succeeded William Purves, who can be credited with having initiated HSBC's international diversification strategy. Purves remained at the bank as Chairman until 1998. When Bond stepped down as chief executive in 1998, he took over the chairmanship from Purves. John Bond was succeeded as the group's CEO by Keith Whitson, who had been previously in charge of Midland Bank. The rather uninspiring Whitson (Retail Banker International, 1996) served as the bank's CEO until May 2003, when Stephen Green, a former executive director at the bank's corporate/investment banking and markets division succeeded him. In the period analysed, John Bond played the most dominant role, first in his capacity as group chief executive and then as chairman of HSBC.

5.4.2. Income Structure

5.4.2.1. Structural Overview

Prior to its pivotal decision to buy Midland Bank, the majority of HSBC's earnings⁹ came from the Asia-Pacific region. The takeover of Midland Bank increased HSBC's total assets from GBP 86 billion in 1991 to over GBP 170 billion in the following year. As a result of this deal, HSBC's management was able to broaden the business away from its home base in Hong Kong. Following the purchase of Midland Bank, 45% of HSBC's revenues came from the UK (1993) and 4% from the rest of Europe (mainly Germany and Switzerland). In 1993, Hong Kong still contributed 28% to the group's revenues, while 11% came from other countries in the Asia-Pacific region. At the time 12% of revenues already stemmed from the Americas, with the majority coming from Marine Midland Bank in the USA (acquired in 1987) and HSBC's Canadian operations¹⁰ (HSBC, Annual Report 1993).

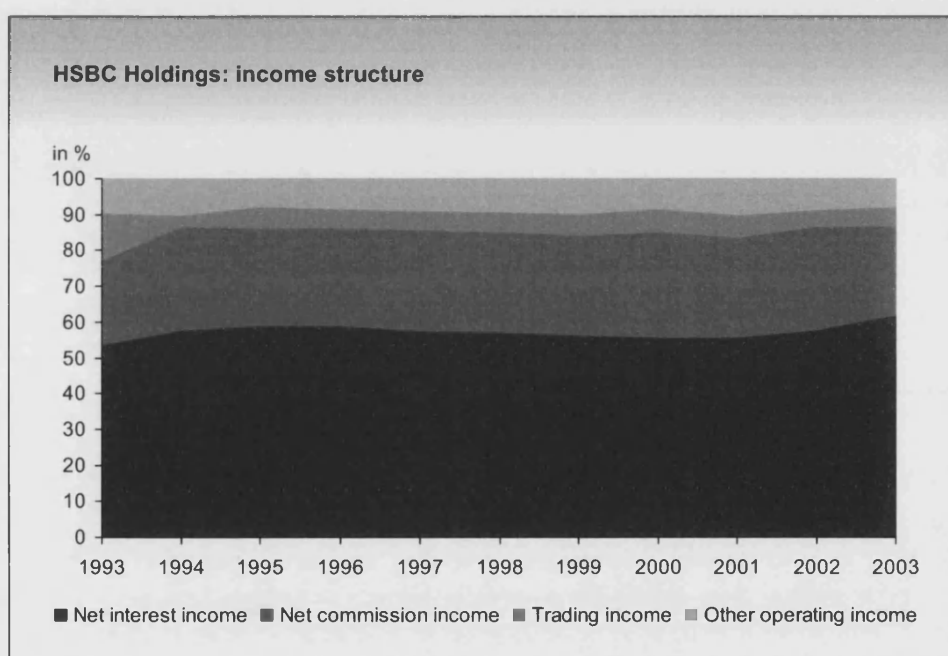
Between 1993 and 2003, HSBC continued its internationalisation strategy through acquisitions, thereby reducing its dependence on the Hong Kong and British banking markets. During these ten years HSBC's most substantial acquisitions were Republic National Bank of New York for USD 9.9 billion in 1999, the EUR 11.1 billion takeover of Credit Commercial de France (CCF) in 2000, and the USD 14.2 billion Household International deal in 2003. In 2003, HSBC spent an additional USD 1.4 billion on the acquisition of Bank of Bermuda. Through numerous small and medium-sized acquisitions, HSBC could as well expand its Latin American operations during the 1990s. For example, it bought Banco Roberts in Argentina for USD 600 million in 1997. HSBC's largest deal in South America was the USD 1 billion acquisition of Banco Bamerindus do Brasil in 1997. In 2002, HSBC took over the failing Mexican bank Grupo Financiero Bital and injected fresh capital at a total cost of USD 1.9 billion.

This series of large acquisitions accompanied by several smaller ones increased the international diversification of operating income. In 2003, after

⁹ 61% of operating income and 100% of profit before taxation in 1991 (HSBC, Annual Report 1992).

¹⁰ HSBC expanded its Canadian business by taking over the Canadian operations of three UK retail banks. In 1990, it bought Lloyds Bank Canada, in 1996 Barclays Bank of Canada, and in 1998 National Westminster Bank of Canada. Midland Bank of Canada already transferred its business to Hongkong Bank of Canada (part of HSBC group) in 1988 (HSBC Holding, 2003b).

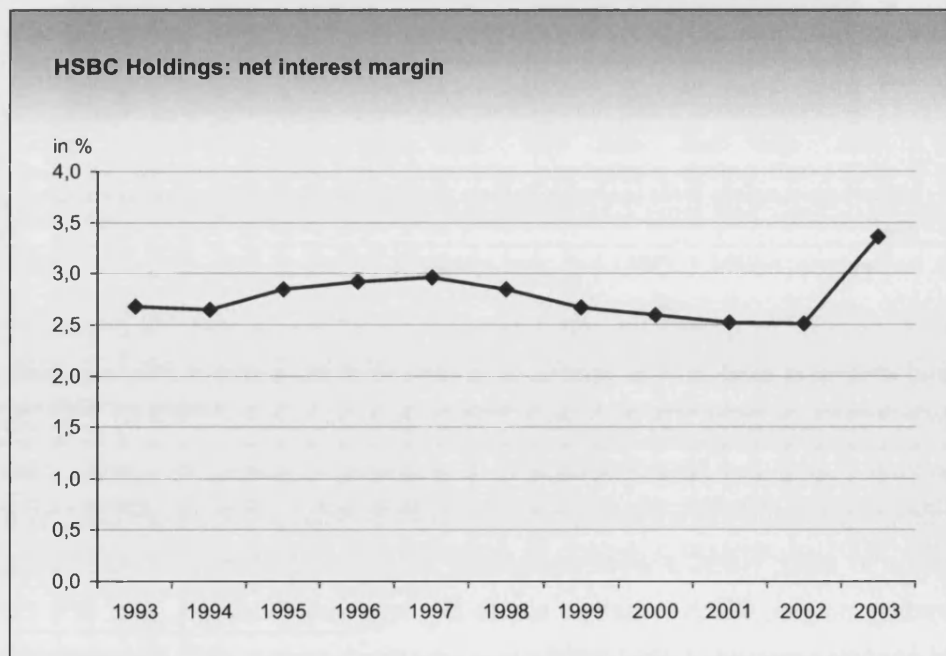
ten years of expansion, HSBC generated 41% of its operating income from the American continent (North & South) compared to just 12% in 1993. The stronger US and Latin American exposure was responsible for the relative decline of income originated in Hong Kong, which fell to 15% in 2003 from 28% ten years previously. Europe, including the UK, also lost significance as it only contributed 15% of the group's operating income in 2003, down from 49% in 1993. As a result of the improved performance of HSBC's UK operations and the profitable growth on the American continent, the geographical split of pre-tax profit was more balanced in 2003 than it had been in 1993. While 59% of the group's profit before tax still came from Hong Kong in 1993, the profit contribution from the former British colony declined to 29% in 2003.



Despite HSBC's growth through strategic acquisitions in both the developed and emerging markets, its income structure remained stable during the years from 1993 until 2003. On average HSBC's operating income grew by 13% per annum during the period analysed. In absolute numbers, the bank's total operating income more than tripled to USD 41.6 billion in 2003 from USD 12.4 billion in 1993. HSBC's weak investment banking exposure is reflected in its trading income, which remained stable at a relatively moderate level of 6.1% of operating income in 1993-2003.

On average 57% of the bank's operating income originated from lending and deposit-taking activities and was therefore booked as net interest income. HSBC suffered only a moderate decline in net interest margin, which fell from 2.68% in 1993 to 2.51% in 2002. Due to the acquisitions of Household International and HSBC Mexico the group's net interest margin increased to 3.29% in 2003 and was therefore considerably above the 1993-2002 average of 2.72%. Without these acquisitions, which enhanced the interest margin, the group's underlying net interest margin would have been 2.46% in 2003. In particular, the high-margin consumer finance business of Household International lifted the net interest margin by 77 basis points, while HSBC's Mexican business could add another 6 basis points (HSBC, Annual Report 2003).

The takeover of Household International boosted the group's net interest income by USD 10 billion to USD 25.8 billion in 2003. Without the strong rise in HSBC's net interest income in 2003, its compound annual growth rate would not have been 14.5% per annum (1993-2003) but around 10%. The sharp hike in net interest income in 2003 mirrored a relative decline of HSBC's commission income. It fell from 29% in 2002 to 25% in 2003 and therefore below the eleven-year average of 28% of the group's total operating income.



On average, HSBC's trading income contributed 6.1% to its total operating income, fluctuating within a relatively narrow band of between 4.8% and 6.5% from 1995 until 2003. In 1993 trading was an important source of operating income and contributed 13% of HSBC's total operating income. According to the 1993 annual report, this high trading income originated from Midland Bank. "The increase was mainly [...] a result of higher volume of business, favourable market conditions and the creation of Midland Global Markets" (HSBC, Annual Report 1993, p. 11).

In 1994 the bank's trading income was 76% lower than in the previous year. The decline resulted from a loss on proprietary trading operations, poor dealing in securities and interest rate derivatives. Trading results were strong in 1993, weak in 1994 and then stable from 1995-2003, suggesting that Midland's risk management improved two years after HSBC had taken over the ownership.

Unlike the other British banks analysed here, HSBC pursued a consistent internationalisation strategy between 1993 and 2003. The bank's income structure changed profoundly in terms of geographic origination, but the type of income was relatively stable over time. The acquisition of Midland Bank in 1992 was driven by management's urge to reduce the group's dependence on Hong Kong, building on its historical connection with Britain, rather than considerations about entering the European common market. The following section will analyse how HSBC's investment/corporate banking activities, asset management operations and retail banking business evolved in the course of the bank's internationalisation strategy.

5.4.2.2. Corporate and Investment Banking

When HSBC was founded in 1865, its main purpose was to finance trade¹¹ out of South East Asia. As a result, the bank has traditionally had a strong commercial basis with an international outlook. Despite its commercial banking roots and long track record in dealing with corporate clients, HSBC found it difficult to develop a strong position in international investment banking in the 1990s (Graham, FT, 5 January 2000). It laid the foundations for its capital markets expertise through the acquisition of the British brokerage firm James Capel & Co in 1986, at the time of the Big Bang. Through the takeover of Midland Bank, it was able to further expand its investment banking operations as it gained control over merchant bank Samuel Montagu.

At the beginning of the 1990s the majority of HSBC's profits were still derived from its separate domestic commercial banking operations. Although the bulk of revenues came from Asia, in particular Hong Kong, its earnings structure reflected the enormous autonomy of its numerous subsidiaries scattered around the world. Due to rising demand from customers for disintermediation services as well as the internationalisation of the bank's client base, HSBC began to revise its corporate banking strategy in the early 1990s. Subsequently, the bank tried to shift its balance of business towards international investment banking. However, HSBC soon had to realise that the risks of investment banking are different from those involved in the traditional corporate banking business. For example, in 1994 the group's chairman William Purves, made clear that HSBC would concentrate on trading for its clients rather than for its own account, after it had experienced volatile proprietary trading results in 1993/94 (HSBC, Annual Report 1994, p. 5).

In 1994 HSBC began to realign its geographical structure to reflect its functional business operations and launched a first initiative to create an integrated investment bank (Gapper, FT, 1 March 1994). The initial efforts concentrated on consolidating the institutional equity securities activities of James Capel and the merchant banking activities of Samuel Montagu in 1995. These two operations became the nucleus of HSBC Investment Banking, which comprised merchant banking, equity securities, asset management, private banking and trustee activities (HSBC, Annual Report 1995). A year

later HSBC merged the European operations of its securities arm James Capel with the bank's merchant bank, Samuel Montagu. However, in the UK, James Capel and Samuel Montagu remained separate entities and merely received the "HSBC" prefix (The Independent, 30 January 1996; Tehan, The Times, 30 January 1996).

For the following ten years, HSBC's management spent a good deal of time realigning the group's investment bank with its commercial bank (Capell, BusinessWeek, 30 May 2005; Waples, Sunday Times, 19 February 2006). In an effort to boost HSBC's high-margin advisory work, management decided to link its investment bank with its main corporate lending business in 2002. As management had already explained in the 1996 annual report, "investment banking is complementary to our commercial banking activity, and particularly relevant to us in newer markets, where customers look to go beyond the traditional commercial banking services. We shall organically build our investment banking business to become a preferred provider of investment banking services to our government, corporate and institutional clients around the world" (HSBC, Annual Report 1996, p. 15).

During the period analysed HSBC tried to expand its investment banking activities without any major acquisitions. Its organic growth strategy was also publicly affirmed when John Bond clearly ruled out the possibility of buying an investment bank (Timmons, The International Herald Tribune, 3 November 2004). Management's decision not to acquire a major US investment bank did not help HSBC to be perceived as a prominent player on the capital markets. Its US corporate business was mainly built around Marine Midland Bank, which became a wholly owned subsidiary in 1987 when the bank raised the 51% stake it had bought in 1980.¹²

Although HSBC received US regulatory approval to underwrite and distribute debt and equity securities in February 1996, it was not able to build up any

¹¹ Trade financing remained at the heart of HSBC's activities. For example, in 1994 HSBC formed an alliance with Wells Fargo to set up the Wells Fargo HSBC Trade Bank to provide better trade finance for US middle market companies engaged in international trade.

¹² HSBC experienced one major setback in its US corporate business with its "Concord Leasing" unit. Concord Leasing became a loss-making operation as it primarily financed the ailing US airline industry. In 1993 Concord Leasing reported a loss of USD 244 million and in the following year the loss was still USD 197 million. Subsequently Concord Leasing tried to shift its financing business into the construction, transportation and communications sectors. In 1995 Concord Leasing was finally integrated into HSBC's main US subsidiary, Marine Midland Bank (HSBC, Annual Report 1995, p. 4). In the same year, Marine

substantial investment banking presence in the US in the following years (HSBC, Annual Report 1995, p. 4; Graham, FT, 5 January 2000). It appears that HSBC's initiatives to position itself as a recognised player on the international investment banking scene were on the whole somehow half-hearted. The bank's partnership with medium-sized US broker Brown Brothers Harriman in the area of equity research in 2000 also suggests a reluctance to pursue a more aggressive poaching or acquisition-led strategy.

HSBC's rather thrifty approach towards developing international investment banking expertise showed when it stopped paying cash bonuses to its investment banking employees in 1998. Instead, management introduced a bonus system under which half was paid in HSBC shares as part of a deferred compensation scheme. The different remuneration packages in transaction (investment) banking and traditional, i.e. transformational, commercial banking can reinforce the different risk cultures that prevail in these two types of businesses. In February 2002, HSBC even announced that it would cut investment banking bonuses to zero. This decision caused an exodus among senior staff (Saigol, FT, 29 April 2002; Saigol, FT, 21 May 2002; Ringshaw, Sunday Telegraph, 4 August 2002).

Midland Bank further expanded through various small acquisitions, of which most were intra-group, such as the takeover of Hongkong Bank's six New York branches.

5.4.2.3. Asset Management

HSBC Asset Management was formed in 1993 when the asset management operations of the HSBC group were restructured and its regional units were unified. Therefore HSBC Asset Management comprised James Capel Fund Managers in Europe, Wardley Investment Services in the Asia-Pacific region and Marinvest in the US. HSBC Asset Management became part of HSBC Investment Banking and was responsible for managing the investments for retail customers and for institutional clients. HSBC Asset Management began offering the full range of fund products, including unit trusts, mutual funds (retail funds), offshore umbrella funds and Individual Savings Accounts ('ISAs').

Despite the division's global reach, funds under management were just USD 30 billion in 1993, and the profit contribution (GBP 32 million) from asset management was about 1.2% of the group's 1993 pre-tax profit (HSBC, Annual Report 1993). In the following ten years, HSBC retained its threefold geographic fund management structure (Asia-Pacific, Europe and the America). While a global committee drawn from the regional teams decided the overall asset allocation, HSBC Asset Management adopted a local fund management concept under which clients' assets were managed as close as possible to the market in which they were invested.

In 1998, when HSBC Asset Management had still only USD 50 billion in assets, Stephen Green, who was at that time head of HSBC Investment Banking (he became CEO of HSBC Holdings in 2003), demonstrated the group's commitment to asset management when he said, "asset management is one of the core businesses within investment banking and we see it as strategically important, especially given the expectations for the growth of investible funds from institutional pension funds and individuals" (Capon & Marshall, Euromoney, June 1998).

Just like with the group's overall investment banking strategy, HSBC avoided the great leap forward and did not make any major acquisitions of stand-alone fund management houses. Nevertheless, HSBC successfully grew its assets under management through selective acquisitions of small and medium-sized financial institutions around the globe. Most of these institutions operated their own asset management arm, which was integrated into HSBC's existing asset

management infrastructure. Despite this piecemeal approach, the bank was able to grow funds under management to USD 137 billion by 2000. In the following three years, two large acquisitions, namely CCF and Household International, contributed to a strong rise in assets under management. Consequently HSBC's assets under management amounted to USD 399 billion at year-end 2003 (HSBC, Annual Report 2003, p. 56).

5.4.2.4. Retail Banking

Prior to the acquisition of Midland Bank, HSBC's retail banking activities mainly concentrated on Hong Kong where the bank operated an extensive branch network. Through the takeover of Midland Bank, retail banking gained significance in HSBC's strategy. HSBC's entry into the UK retail market proved timely as the British economy was gradually recovering from its recession.¹³ In 1993, inflation was at a 30-year low and consumer spending was slowly picking up. The low inflation rate and relatively low interest rates led customers to turn away from conventional savings towards investment products (HSBC, Annual Report 1993).

Midland Bank responded to this disintermediation trend through the pension and investment products of its personal financial services business and a new range of life assurance-based savings programmes. In addition, HSBC completed the restructuring of Midland Bank's British retail network in 1993. The previously separate personal and business customer streams were brought together and management decided to improve the quality of the retail banking service by putting experienced bankers back in high-street branches (HSBC, Annual Report 1993).

When HSBC bought Midland Bank, it also acquired First Direct, Britain's market leader in direct banking. As Britain was gradually coming out of recession, First Direct was able to benefit from rising demand for home mortgages. While First Direct, which was founded in 1989, only had 250,000 customers in March 1993, its client-base rose to more than 1 million by the end of 2003. Due to First Direct's rapid growth and subsequent efficiency gains, it was able to report its first full-year of profitability in 1995 (HSBC, Annual Report 1995, p. 14).

Although First Direct became a profitable and successful¹⁴ stand-alone unit of HSBC, the profits it contributed to the HSBC group remained negligible and were below 1% even in 2003 (Bank Marketing International, 28 August 2003;

¹³ In 1993 GDP rose by 2%, the best rate since 1989.

¹⁴ A less successful online banking venture than First Direct was HSBC's cooperation with Merrill Lynch, launched in 2000. Merrill Lynch and HSBC wanted to serve the mass-affluent market with investment-led, broking and banking services. Initially the joint venture targeted the Canadian and Australian markets, and a research capability was also available in the UK. Merrill Lynch and HSBC planned to also expand into the German, French, Hong Kong and Japanese markets (HSBC, Annual Report 2000). However, as this online private banking joint venture fell short of expectations it was absorbed into HSBC in May 2002, just two years after its beginning (Ringshaw, Sunday Telegraph, 4 August 2002).

Ross, FT, 27 March 2004). With the exception of First Direct, HSBC pursued a “clicks and mortar” strategy. In other words, its internet offerings had to mesh with HSBC’s existing distribution channels (HSBC, Annual Report 2000).

HSBC’s acquisition of Midland Bank was certainly the most decisive strategic move during the period analysed. However, it should not be forgotten that there were also many other important deals that turned HSBC into a global retail bank, with 47% of pre-tax profits coming from retail banking¹⁵ in 2003. A case in point is the less prominent, albeit strategically no less relevant, takeover of French bank CCF for USD 12.5 billion in 2000.

At the time CCF was France’s seventh largest bank with businesses in personal, corporate and investment banking. Despite being a universal bank, CCF’s major strength was its focus on the mass-affluent personal retail banking market in France. In total CCF operated 650 branches in France, serving 1 million customers, predominantly in the country’s wealthiest regions (HSBC, Annual Report 2000). The acquisition of CCF primarily served HSBC’s strategic objective of expanding its personal wealth management business. Buying CCF also meant gaining a significant client base in continental Europe.

The CCF deal was typical of HSBC’s internationalisation strategy, which mainly concentrated on acquisitions that allowed the bank to gain access to established structures and networks. Traditional universal banks with a strong bias towards retail banking tend to have a highly developed system of structures and networks. In contrast, pure investment banks generate the bulk of revenues by a much smaller number of employees. These “revenue hubs” are more sensitive to organisational changes and may be more difficult to integrate into an existing organisation. HSBC’s refusal to acquire a large US investment bank in order to get a foothold on the US market, but to concentrate on a series of acquisitions in retail and private banking, illustrates this strategy.

In 1996 HSBC’s retail and private banking operations in the USA were still concentrated on the State of New York. Several smaller deals¹⁶ enabled the

¹⁵ This comprised the three divisions Personal Financial Services, Private Banking and Consumer Finance.

¹⁶ HSBC acquired 11 branches from the “East River Savings Bank”, 79 retail branches from the “First Federal Savings and Loan Association” in New York State and 15 mortgage origination offices in nine other US states.

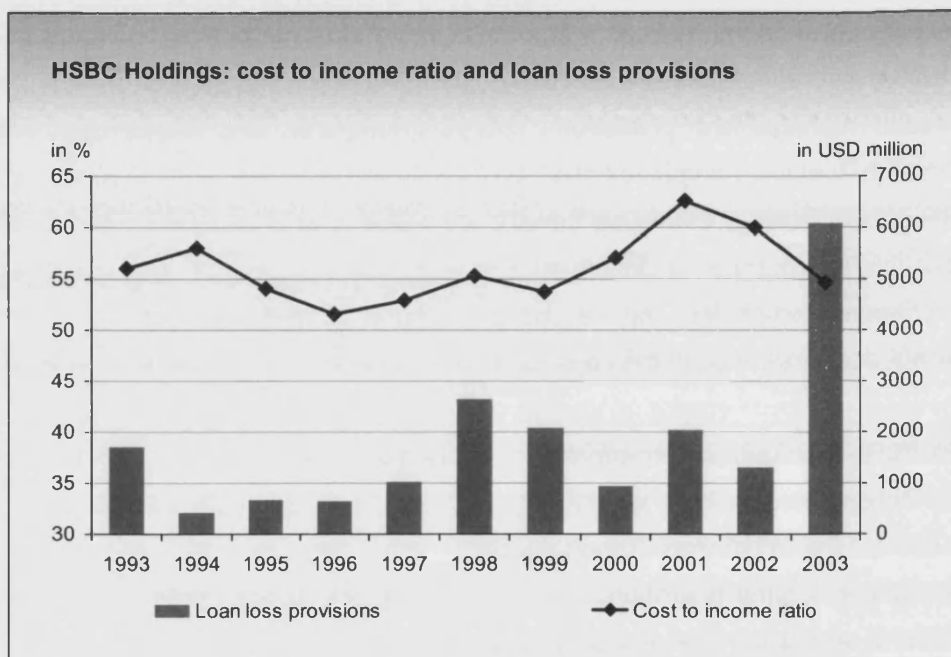
bank to continuously expand its branch network during 1996 and 1997. The acquisition of Republic New York Corporation and Safra Republic Holdings for USD 9.85 billion, which was completed in 1999, further strengthened the bank's presence in New York and improved its international private banking capabilities. Yet HSBC's pathbreaking move into the US retail market came in 2003 through the USD 14.8 billion acquisition of the consumer finance bank, Household International (HSBC, A brief history). Household International brought HSBC a network of over 1,300 branches, providing consumer finance to 53 million customers across 45 US states.

HSBC built up its insurance capabilities using the same rationale as for expansion of its international personal financial services business. During the 1990s, insurance business gradually became a key component of the bank's wealth management philosophy. HSBC's insurance businesses operated through various companies that engage in life and pension underwriting, insurance broking, employee benefits consultancy and general property and casualty insurance underwriting. Several acquisitions of medium-sized insurance companies, as well as the insurance operations of the banks acquired, contributed to the continuous rise of the bank's insurance activities.

In 1996 management committed itself to furthering the group's insurance operations and said it would define them as the group's third business segment (HSBC, Annual Report 1996). Despite the growing significance of the group's insurance operations the company did not disclose premium income from its insurance operations in its annual report until 2005, when it totalled USD 5.4 billion, i.e. around 9% of total operating income. The risks that arise with a universal banking expansion and the gradual build-up of a bancassurance model are subject of the following section.

5.4.3. Cost and Risk Management

The risks that HSBC were underwriting through its insurance operations were not disclosed in the group's annual report during the period analysed. However, the 2005 annual report revealed that 58% of net earned premiums were from non-linked life insurance policies, 10% were from unit-linked life insurance policies and the remaining 32% originated from non-life policies. The structure of premium income has probably not changed substantially since 2003, as HSBC did not make any major insurance acquisitions in these two years (interview, investor relations, Tuesday, 4 April 2006).



The high proportion of non-linked life insurance policies, that is where the investment risk is largely borne by the shareholders of HSBC and not the policyholders, along with a retention-rate of 87%¹⁷ suggests that a relatively high degree of risk was carried on the bank's books (HSBC, Annual Report 2005, p. 258). Although it was not disclosed, it is likely that a substantial proportion of premium income originated from the bank's retail operations as HSBC's bancassurance strategy mainly served the purpose of expanding its wealth management business.

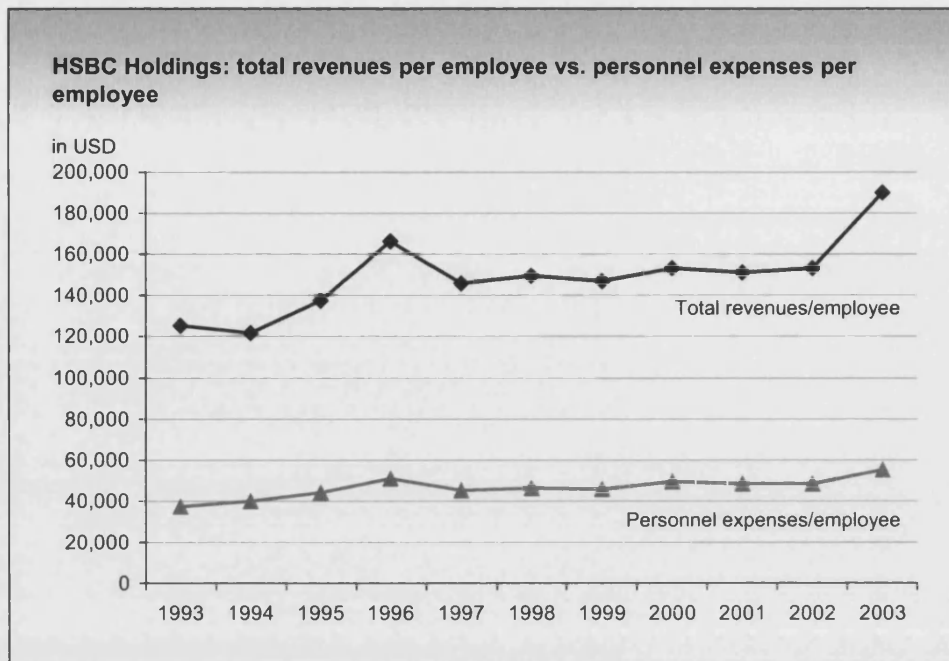
The bank's strong position in wealth management and its rather lean investment banking exposure was visible in a stable and moderate cost income ratio. The cost income ratio fluctuated between 52% and 63% between 1993 and 2003, with an average of 56%. Given the group's continuous expansion and integration measures, this low cost income ratio is evidence of a disciplined cost policy. Yet, the downside of such stringent cost discipline is the difficulty of breaking into new business areas such as investment banking. A bank without a clear investment banking reputation usually has to pay a hefty premium to recruit investment bankers. The scarcity of investment banking talents, who can generate commission from capital markets and M&A transactions, keeps salaries high and does not make it easy for new players to enter international investment banking.

An additional aspect of HSBC's cost control is its long-term strategy of developing its own computer systems to support core activities. Management regarded the right use of technologies as vital to the bank's success and proved great skill in carefully reviewing the risks and opportunities that came from the use of new technologies. Part of HSBC's successful integration strategy was that it swiftly implemented the same systems around the world, enabling it to optimise accounting processes and quickly gain economies of scale (HSBC, Annual Report 1995, p. 7).¹⁸

Moreover, HSBC's internationalisation strategy allowed the relocation of certain back-office services to developing countries in which it was already present and where wages were low. It mainly used outsourcing operations within HSBC group (Business Week Online, 27 January 2006). Staff costs rose during the 1990s, especially in the UK. Therefore, management accelerated its outsourcing to other parts of the world. This mainly affected its UK operations because of the outsourcing of cash and cheque processing services (Griffiths, The Independent, 2 July 2004).

¹⁷ A retention rate of 87% means that 13% of gross premium income was passed on to reinsurance companies.

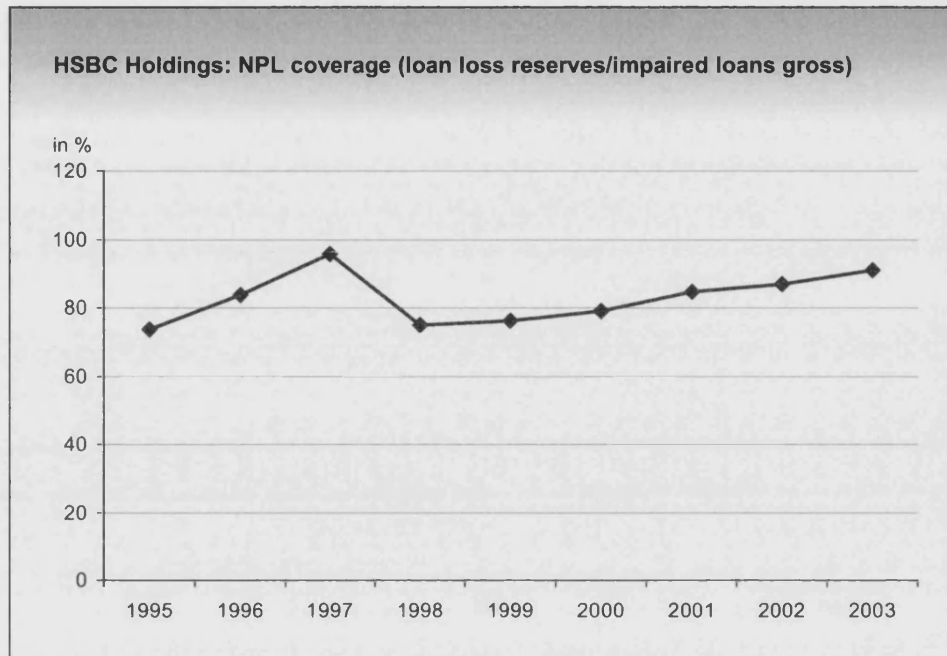
¹⁸ HSBC considered it a major managerial challenge to link the different parts of the HSBC group more closely together through the use of information technology. It distinguished between technologies used to deliver faster, more convenient and more attractive services for its clients and technologies for internal processes, in order to improve efficiency, effectiveness and productivity (HSBC, Annual Report 1996, p. 16).



The proportion of personnel expenses relative to the bank's total operating expenses before risk provisions improved from 56% in 1993 to 53% in 2003. Given the bank's threefold increase of revenues, this 3 percentage point improvement is not overly impressive, corroborating the view that there are limits to scale efficiency in the banking industry. Further evidence is the stable cost income ratio and the comparison of revenues and costs per employee. In 1993, HSBC employed 98,716 staff, compared to 219,286 in 2003. HSBC's total personnel costs per employee rose by a compound annual growth rate of 4.0% during the period analysed. This compares to an average annual increase in revenues per employee of just 4.2%, underlining the limited scale efficiencies of a global expansion policy.

As previously discussed, the cost income ratio is an imperfect indicator of a bank's efficiency, as it does not say anything about the group's risk-management skills. The cost income ratio does not include loan loss provisions. HSBC's acquisition-led growth strategy entailed the risk of taking over loan portfolios, which had not been adequately provisioned for. Although HSBC did not have major loan loss provisions, the relatively high volatility of loan loss provisioning suggests that due to these acquisitions HSBC either over- or under-provisioned at times. Overall, HSBC's loan portfolio increased

by a factor of 3.6 during the period analysed, rising from USD 150 billion in 1993 to USD 543 billion in 2003.



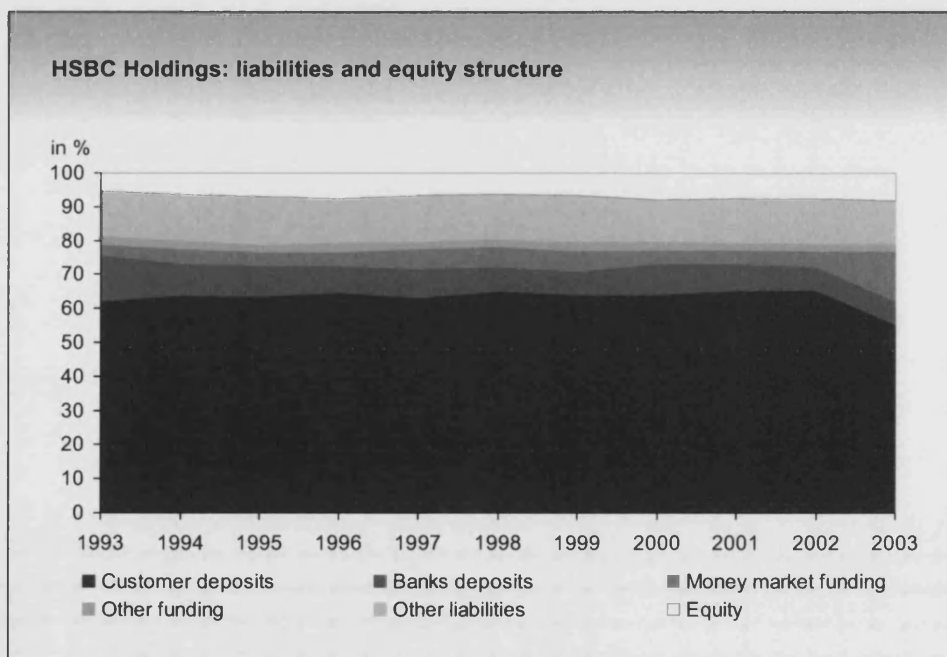
Despite the strong loan portfolio growth and loan loss volatility, HSBC's loan loss provisions ate up on average just 13% of net interest income between 1993 and 2003. Taking into account that loan loss provisions remained low, a coverage ratio below the usual comfort level of 100% was acceptable. Although HSBC's loan loss provisions relative to its total operating expenses were on average only 12%, the bank¹⁹ did not build up its loan loss reserves to such an extent that they would cover or even exceed problem loans. The low coverage ratio suggests that, despite a cautious lending policy, HSBC's acquisition-spree posed a constant challenge in terms of risk management.

¹⁹ This compares to 12% at Barclays and 13% at Lloyds TSB.

5.4.4. Asset-Liability Structure

An analysis of HSBC's assets and liabilities reveals three fundamental structural changes during the period analysed. The bank's "other earning assets" increased from 17% in 1993 to 23% in 2003 as a proportion of total assets. Other earning assets comprise, for example, securities instruments, equities and treasury bills. This development originates largely from the bank's insurance operations and growing activity on the international capital markets, not least reflecting HSBC's effort to build up investment banking expertise.

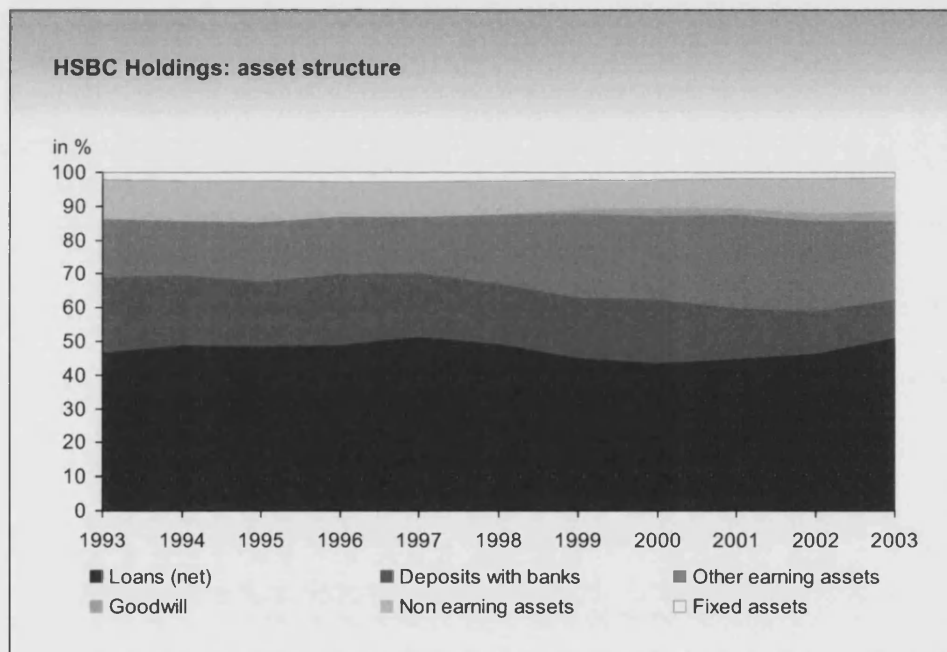
An additional structural shift that took place during this time was the decline of deposits held with other banks (22% in 1993 versus 11% in 2003). A similar trend can be identified at other banks and shows their increased direct activity on the capital markets. Therefore, banks should not be described merely as "victims" of disintermediation as they were in fact important shapers of this development.



The majority of HSBC's funding came from client deposits, which on average comprised 63% of the banks' liabilities and equities. The high proportion of deposits resulted from HSBC's strong retail and personal finance business and remained stable until the acquisition of the consumer finance bank

Household International. The proportion of customer deposits declined sharply as a result of this takeover, falling from 65% in 2002 to 55% in 2003 as the importance of money market instruments increased.

Most revealing is the impact of the Household International deal on HSBC's asset-liability structure as shown by the development of net loans relative to deposits. In 2002, 64% of deposits were tied up in loans, whereas by the end of 2003 the ratio had risen to 82%. Until HSBC acquired the consumer finance bank, on average 48% of its assets were loans. Following the Household International deal in 2003, this ratio increased to 51%, up from 46% in 2002, mirroring the nature of the consumer finance business.



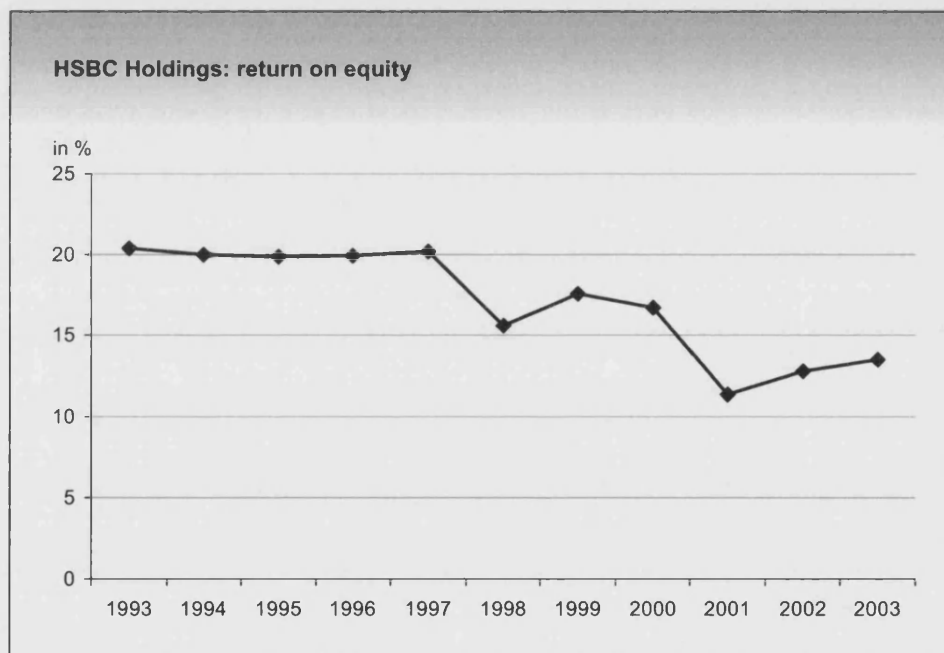
Due to HSBC's frequent acquisitions, its tier 1 ratio did not rise significantly despite retained earnings (on average 41% of earnings). HSBC's tier 1 ratio remained on average at 9.1 % and peaked at 9.9% in 1996, leaving the bank very well capitalised. However, even then its chief executive, John Bond, said: "As long as we can make a respectable return on our shareholders' money, we don't see the need to return capital. If we did have surplus capital, we would probably prefer to do it through the payout rather than through share buy-backs" (Graham, FT, 4 March 1997). The clarity of this statement and the ongoing acquisitions meant the issue of share buy-backs was not raised again

during the period analysed.

HSBC's sound capital position is also reflected in its average equity ratio of 7% during the period analysed, whereby it was just 5.3% in 1993 as it still bore the marks of the recent takeover of Midland Bank. It is also worth noting that HSBC did not make particularly strong use of hybrid or subordinated bonds as a means of financing its business. These instruments played a minor role and were responsible for just 2.4% of the group's funding.

5.4.5. Profitability

HSBC did not formulate a strategy that set certain profitability targets until the end of 1998, when it introduced the concept of Managing for Value. The goals of Managing for Value were to beat the average total shareholder returns (TSR) performance of a peer group of financial institutions and to double shareholder return over a five-year period (HSBC, Annual Report 1998). Managing for Value was neither particularly innovative nor timely and merely followed many other banks²⁰ that had recognized the growing importance of the shareholder value concept. In its 2003 annual report, HSBC's management proudly reported that it had achieved these targets (HSBC, Annual Report 2003).²¹



During the period analysed, HSBC's net profit grew by an average of 12.2% p.a. while the compound annual growth rate for total operating income was 12.9%. In absolute figures the group's net profit rose from USD 3.1 billion in 1993 to USD 9.7 billion in 2003. While revenues and profits rose strongly in absolute terms, the return on equity actually declined between 1993 and 2003.

²⁰ For example, Lloyds Bank had already set return-on-equity targets in 1984.

²¹ Subsequently Managing for Value was superseded by an equally innovative strategy, called Managing for Growth.

On average HSBC's return on equity was 17.3% after tax and 22.9% before tax during this period.

Between 1993 and 1997, the bank's return on equity still exceeded 20%, but then dropped sharply to 15.6% in 1998 – the year when management presented "Managing for Value". This was due to the poor economic situation in several Asian countries in which HSBC has a strong presence. Moreover, the economic uncertainty over Asia affected HSBC's banking operations in Latin America (HSBC, Annual Report 1998). Loan loss provisions rose to USD 2.6 billion in 1998, up from USD 1 billion in the previous year. Even in 1999, HSBC's loan loss provision remained relatively high, eating up 17.1% of the group's net interest income. This compares to 22.6% in 1998 and the eleven-year average of 13.4%.

By 1993, HSBC had achieved the goals set in 1998, but its return on equity did not regain the same levels as before the Asian crisis and was on average just 14.4%. There is no single factor that could explain the lower profitability expressed in terms of return on equity. The bank suffered partly from higher administrative expenses and write-downs, but loan loss provisions also remained a burden. As it appears impossible from the outside to identify the reasons behind the decrease in profitability, one tentative hypothesis would be that it resulted from the bank's growing organisational complexity.

As discussed above, a case in point would be the increased volatility of HSBC's loan loss provisions as evidenced by over- and under provisioning for problem loans following its numerous acquisitions. For instance, HSBC's loan loss provisions soared after the takeover of Household International: 23.6% of total net interest income was consumed by loan loss provisions, so the return on equity only improved to 17.8% (2003) compared with 17.4% in 2002, despite the higher net interest margin. The acquisition of Household International helped HSBC boost net interest margin to 3.36% in 2003. From 1993 until 2002, HSBC's net interest margin moved between 2.96% (1997) and 2.51% (2002) and was finally lifted by the high margin consumer finance business of Household International.

5.4.6. Conclusion

HSBC pursued an acquisition-led internationalisation strategy during the period analysed. However, Europe and the liberalised European banking market appear to have played only a subordinate role in the group's overall global multi-local corporate strategy. The pivotal move was its entry into the British market in 1992/1993. The acquisition of Midland Bank paved the way for HSBC's internationalisation strategy in retail and commercial banking. In the following years, HSBC developed a global network in private wealth management, including high street banking, and commercial banking through a series of takeovers. At the same time, it avoided overly expensive investment banking endeavours.

Within about ten years, HSBC became a financial services institution that derived half its profit from stable, mature economies and half from the faster growing, albeit more volatile, emerging markets (HSBC, Annual Report 2003). Moving into different interest rate areas, in particular into emerging markets, also served as a means of counteracting disintermediation. Moreover, HSBC's decision to expand into US consumer finance helped to alleviate the pressure on net interest margins. However, geographically diversified income streams also increased exposure to countries undergoing economic and political turmoil. While capital can be quickly reallocated, operating units that provide banking structures are resistant to fast and efficient portfolio adjustments. The embeddedness of operational units does not allow the unfettered application of portfolio theory.

The bank's initial multi-local internationalisation strategy was also reflected in a decentralised leadership structure with varying management styles. However, most of HSBC's top management had worked for many years for the original Hongkong and Shanghai Banking Corporation. It appears that HSBC established a learning culture, which allowed one managerial generation to learn from the previous one. In particular, HSBC's management demonstrated great skill in mastering the incessant integration processes with all the latent operational risks, following each takeover.

The transition from a collection of local banks to a single global brand was one of HSBC's greatest achievements. In 1995 HSBC's management still believed

in retaining local names for local businesses²² and in using HSBC to brand its global businesses, such as investment banking, capital markets, securities trading and fund management (HSBC, Annual Report 1995, p. 7). These global businesses were successively brought together under the HBSC brand name. Eventually, in 2000, HSBC established the “HSBC” logo and hexagon symbol as a global brand, introducing the advertising slogan: “HSBC, the world’s local bank”.

²² In 1995, management still showed confidence in its multi-local brand name strategy. It felt that since customers viewed these banks as domestic, this was an important asset (HSBC, Annual Report 1995).

5.5. Commerzbank AG

5.5.1. Introduction and Status Quo in 1993

When the newly founded Commerzbank went public on 4 March 1870, its shares were 33 times oversubscribed. It was reported that demand was so overwhelming that several hundred interested investors besieged the main entrance of the lead bookrunner, the Hamburg-based bank M.M. Warburg (Commerzbank, 1970). A consortium of Hamburg merchants and private bankers established Commerzbank whose initial name was Commerz- und Disconto-Bank.¹ The driving force behind the establishment of a bank in Hamburg to focus on trade finance was Theodor Wille, a merchant with strong ties to South America.

Right from its inception Commerzbank had an international focus. Long before it opened a branch anywhere in Germany, it became a major shareholder in the London and Hanseatic Bank when it was founded in 1872 (Commerzbank, 1970; Hoover's Company Records, 2007). During the first decades, Commerzbank built close relationships with Scandinavian countries where it often entered into cooperation with local banks (Commerzbank, 1970). Finally, in 1891 the bank began to catch up with its domestic rivals which had built a strong presence in Berlin. Through the takeover of bank J. Dreyfus & Co, Commerzbank acquired branches in Berlin and Frankfurt in 1897. Commerzbank further strengthened its presence in Germany's capital when it bought Berlin Bank in 1905.

In the following years, Commerzbank rapidly expanded throughout Germany by acquiring more than 45 regional and private banks (Commerzbank, 2005). Notable developments were the mergers with Mitteldeutsche Privat-Bank (1920), Mitteldeutsche Creditbank (1929), and the forced merger with Barmer Bank-Verein (1932) in the wake of the crisis in the German banking sector. The banking crisis weakened Commerzbank to such an extent that it had to be bailed out by the state, which thereafter owned 70% of the bank. Five years later, Commerzbank was full privatised again through the placement of shares

¹ One of the founding members was Frankfurt banker Adolph B.H. Goldschmidt, grandfather of British financier James Goldsmith.

held by the government and Reichsbank (Commerzbank. 2005).² In 1940 Commerzbank operated 359 branches in Germany and changed its name from Commerz- und Privat-Bank to Commerzbank.

The bank's strong standing in central Germany meant that 45% of its branches became part of the zone controlled by the Soviet Union after the Second World War. Commerzbank experienced the same fate as Deutsche Bank and Dresdner Bank and was broken up into three smaller banks by the Allied authorities (Commerzbank, 1970; Commerzbank, 2005). However, these were re-amalgamated in 1958 and Commerzbank resumed business as a universal bank with 185 branches, 317,000 clients and 7,690 employees. By the end of 1969, Commerzbank operated 675 branches with 14,290 employees and served 1.4 million clients. After having successfully rebuilt its German operations, Commerzbank began internationalising its business in the late 1960s and throughout the 1970s.³ A New York representative office was opened in 1967. This was converted into a full-scale bank branch in 1971, becoming the first branch of a German bank in the United States (Commerzbank, 2005).

Commerzbank introduced its new logo, which it still uses today, shortly after Europartners had been formed in 1972. Analogously to several other banking clubs established at the time, Europartners was a cooperation with Cr dit Lyonnais⁴, Banco di Roma and Banco Hispano Americano (now part of Banco Santander Central Hispano). The purpose of such banking clubs was not so much to benefit from the increasing integration of the European market, as to counter the perceived threat posed by large US banks (FT, 10 May 1982).

Commerzbank's logo, developed by a French advertising agency, known as the "quatre vents", meaning the four winds symbol, "was intended to portray the open attitude of the bank and its partners to the world", underlining Commerzbank's international outlook (Commerzbank, undated a).⁵ In theory,

² Commerzbank was involved in the expropriation of Jewish property and the financing of Nazi war efforts. A detailed account of Commerzbank's activities during the Nazi era is provided by Herbst & Weihe eds. (2004).

³ An early initiative was the formation of the International Commercial Bank in London in 1967, which Commerzbank set up with Irving Trust Company, First National Bank of Chicago, Westminster Bank, and Hongkong & Shanghai Banking Corporation (Hoover's, 2007).

⁴ The same logo (but blue on a yellow background) also remained in use by Credit Lyonnais for more than thirty years and was only dropped after the takeover by Credit Agricole in 2003.

⁵ Available from: https://www.commerzbank.com/konzern/geschichte/download/cb_logo_en.pdf [Accessed 12 January 2007].

Europartners was the largest banking organisation in Europe at the time. However, differences in national banking laws and the lack of strategic co-ordination prevented a full merger and Europartners eventually petered out after twenty years and a final attempt to coordinate joint expansion into Eastern Europe (FT, 24 November 1984; Commerzbank, Annual Report 1990; Börsen-Zeitung, 4 September 1999; Commerzbank, 2005).⁶

Like Deutsche Bank and Dresdner Bank, Commerzbank owned substantial shareholdings in German companies. Yet, in contrast to its rivals it divested many of its holdings in the late 1970s and throughout the 1980s (Hoover's 2007). So by 1993, the bank's major investments in industrials amounted to just DM 5.7 billion worth of equity capital (Commerzbank, Annual Report 1993). In 2003, total shareholders' equity allocated to investments in non-banks was EUR 420 million. Although Commerzbank's rapid internationalisation in the 1970s contributed to weak profitability in the early 1980s, it resumed its expansion in the second half of the decade and by 1988 its commercial banking network operated branches in Brussels, Antwerp, Paris, Madrid, Barcelona, London, Hong Kong, Tokyo, Osaka, New York, Chicago, Atlanta, and Los Angeles (Hoover's, 2007).

Commerzbank's management regarded German reunification as an opportunity to catch up with its two larger competitors, Deutsche Bank and Dresdner Bank. Consequently, it launched a DM 500 million project to expand into Eastern Germany by setting up 120 branches. It decided against cooperation with or the takeover of existing banks and pursued an organic growth strategy in the five new Eastern German states (Commerzbank, Annual Report 1990; Hoover's, 2007). By end-1993, Commerzbank had 300,000 customers in Eastern Germany, which were served by 2,150 employees in 113 branches (Commerzbank, Annual Report 1993).

Encouraged by the initial enthusiasm about the progress made in Eastern Germany, Commerzbank's management felt it should counter the challenges of the Single European Market through internationalisation (Commerzbank, 2005; Hoover's, 2007). For most of the remainder of the decade analysed in the following pages, the bank was led by Martin Kohlhausen. In 1993,

⁶ Some years later Commerzbank's CEO Kohlhausen blamed the two state-owned banks in Europartners (Credit Lyonnais and Banco di Roma) for insufficient commitment to profitability targets (Börsen-Zeitung, 12

Kohlhaussen had already been chief executive officer of Commerzbank for two years,⁷ a position he held until May 2001, completing two five-year tenures.⁸ Klaus-Peter Müller, who joined the board of management in 1990, mainly to oversee the bank's international activities, succeeded Kohlhaussen as CEO. In accordance with German corporate governance tradition, Kohlhaussen was then appointed chairman of the bank's supervisory board.

November 1998).

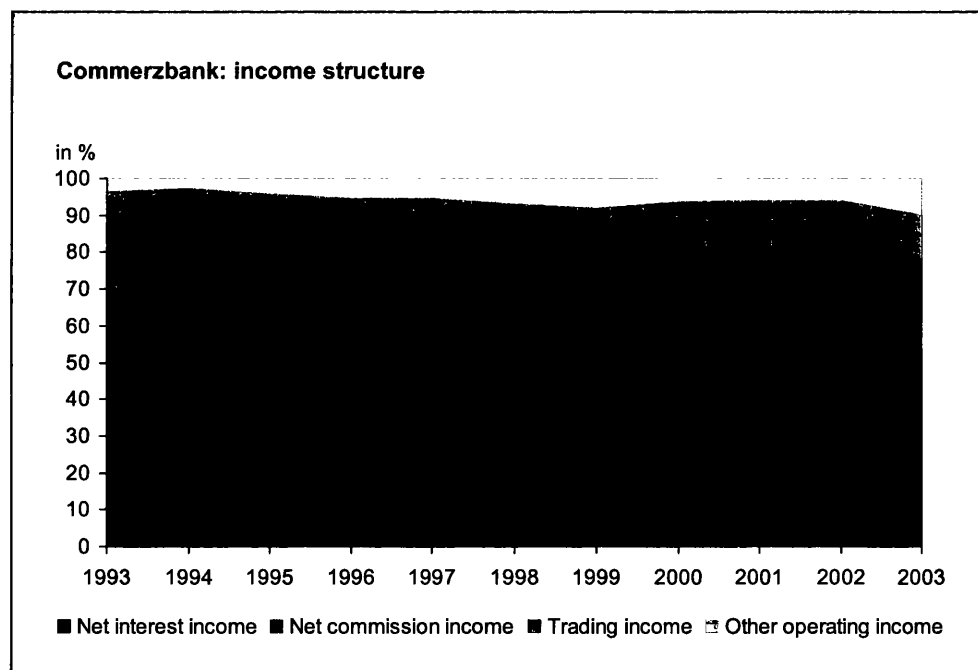
⁷ He joined the company in 1965 after graduating in law and became a member of the board in 1982.

⁸ From 1991 to 1999, former CEO Walter Seipp was chairman of the supervisory board. He was succeeded by Dietrich-Kurt Frowein, also a former board member of Commerzbank.

5.5.2. Income Structure

5.5.2.1. Structural Overview

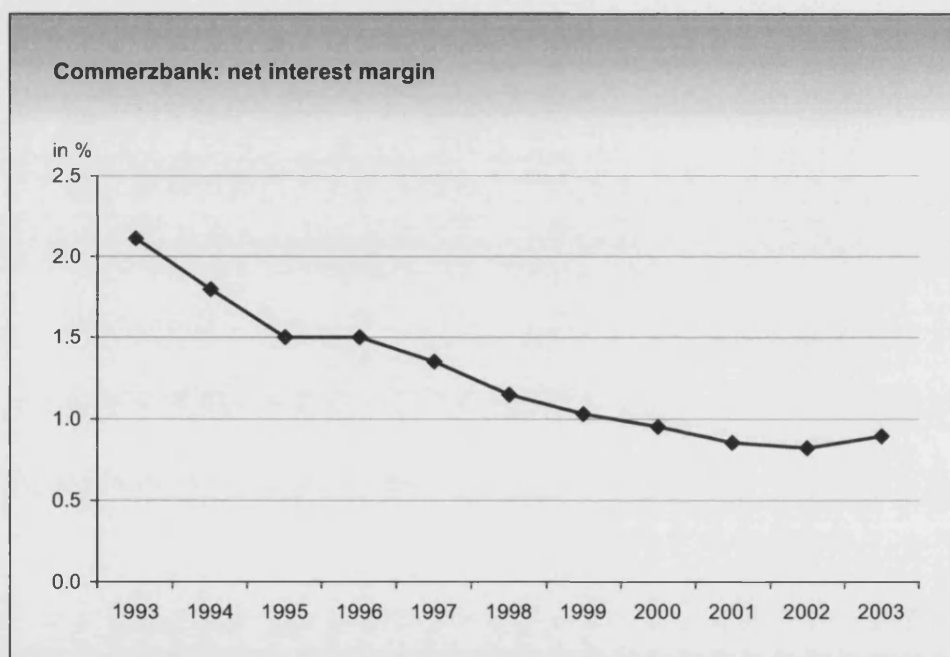
Commerzbank's rapid internationalisation prior to the launch of the Single European Market is reflected in the geographical breakdown of revenues in 1993. 30% of revenues⁹ came from outside Germany, largely from other European countries (24%). Commerzbank published a regional split of interest income in its 1993 annual report, but not the respective interest expenses. In the following years, interest expenses were also disclosed. The figures for 1994 show that Commerzbank's international loan portfolio generated 36% of the bank's gross interest income but only 15% of net interest income.



Notwithstanding the geographical split of loan loss provisions, it may be concluded that Commerzbank earned relatively little from its international lending as it had to spend most of its income on refinancing costs. As of 2003, Commerzbank no longer distinguished between its German and European operations. In its geographic breakdown, it only disclosed its European business, which was responsible for 89% of revenues in 2003. At the time, 22% of the group's staff were employed abroad – a strong rise from just 6% in 1993. Despite that higher proportion of personnel abroad, the bank's revenues

showed a high degree of dependency on the German economy.

In 1993 Commerzbank's management demonstrated insurmountable optimism in its assessment that the 1.1% decline in German GDP growth in that year would spark reforms, making the country more competitive (Commerzbank, Annual Report 1993). During the following decade, the German economy grew by a compound annual growth rate of 1.2%, while the country's unemployment rate rose from 7.7% in 1993 to 9.6% in 2003. Against this macroeconomic background, Commerzbank expanded its loan portfolio by an average of 5% p.a. Yet, net interest income increased by a moderate annual rate of 0.7% p.a. The bank's poor net interest income was primarily a reflection of its falling net interest margin, which was due to an unfortunate refinancing mix and weak pricing power. Commerzbank's net interest margin still stood at 2.11% in 1993, but had dropped to 0.89% by 2003.



The meagre results from Commerzbank's lending business, along with the greater importance of commission and trading income, contributed to the relative decline of net interest income over time. In 1993 Commerzbank still generated 65% of its total operating income from transformation activities, but by the end of 2003 net interest income accounted for just 44%. Evidently, the

⁹ In 1993 revenues comprised interest income (but not interest expenses), current income, commission

deconsolidation of the mortgage bank Rheinhyp in 2002 had a marked impact on Commerzbank's net interest income. The deconsolidation of Rheinhyp reduced Commerzbank's loan portfolio by EUR 63 billion (28%) and accounted for an estimated¹⁰ decline of 12% in net interest income (Commerzbank, Annual Report 2002, p. 108).

Besides this deconsolidation effect, Commerzbank's greater dependence on trading and commission income resulted from its attempt to develop expertise in investment banking services in the late 1990s and the revenue growth from the sale of third-party financial products. In particular, the successful sale of insurance policies and mortgage savings on behalf of its bancassurance partners contributed to commission income. From 1993 to 2003, net commission income increased on average by 7.9% p.a. Trading income grew at an even higher average annual rate, namely, by 10.1% p.a. Consequently, trading results accounted for 9% and commission income for 29% of Commerzbank's total operating income during the period analysed. This compares to an average of 56% of operating income coming from net interest income during this period. In absolute figures, Commerzbank's total operating income rose from EUR 4 billion in 1993 to only EUR 6.2 billion in 2003, implying a compound annual growth rate of 4.5%.¹¹

Besides these sources of operating income, Commerzbank continuously generated additional income from the sale of diverse investments, albeit to a lesser extent than Deutsche Bank and Dresdner Bank. These non-operating and exceptional items made a positive overall contribution to the bank's net profit, despite exceptional charges and write-downs (a EUR 2.2 billion write-down in 2003 being the most drastic). These exceptional items lifted Commerzbank's pre-tax return on equity by 1.1% p.a. in the period analysed. Given the significant extraordinary charges reported between 2001 and 2003, it might make sense to consider the development for the years 1993 to 2000 separately. In fact, for this period, the net effect of exceptional items were on average EUR 321 million p.a., boosting the group's pre-tax ROE by 4.4%.

income, trading income and other income (Commerzbank, Annual Report 1993).

¹⁰ Commerzbank did not quantify the effect on its net interest income. However, most of the 12.5% net interest income decline in 2002 is probably due to the deconsolidation of Rheinhyp.

¹¹ The year 2000 was Commerzbank's strongest year between 1993 and 2003 in terms of revenues, with total operating income of EUR 7.6 billion.

5.5.2.2. Corporate and Investment Banking

At the beginning of the 1990s, Commerzbank's corporate banking activities largely revolved around lending, bond underwriting, trade finance and some treasury services. Its clientele was mainly German and principally comprised small and medium-sized enterprises, what is known as the German Mittelstand. As part of its client relationship management approach to SME firms, Commerzbank bought and sold stakes in a broad range of companies and as such played the role of an active investor and intermediary (FAZ, 6 March 1997; FAZ, 20 March 1997).¹² Through this kind of participation management, which frequently entailed the placing of shares on the market, Commerzbank widened its experience in capital market transactions and laid the foundations for its subsequent investment banking operations.¹³

Besides its strong footing with the German Mittelstand, Commerzbank's other expertise came from its tradition as a bond underwriter, mainly in DM-denominated bonds (Wittkowski, Börsen-Zeitung, 11 October 1997). From its position as an established underwriter of fixed income instruments, Commerzbank built a reputation as an arranger of syndicated loans in the second half of the 1990s. Commerzbank's strong mortgage banking activities also made it an important issuer of mortgage bonds. Building on its bond expertise and client relationship management with German Mittelstand companies, Commerzbank established investment banking as a separate corporate division in 1995. Through the establishment of its investment banking unit, the bank's internationalisation gained new momentum.¹⁴ Commerzbank regarded itself as a European bank and international expansion therefore had the same priority for management as its German operations (Commerzbank, Annual Report 1999).

Shortly after the demise of communism, Commerzbank had expanded its commercial banking services into Central and Eastern Europe. In 1993, it had offices in the Ukraine, Kazakhstan, Belarus and opened its second Russian

¹² For example, in 1993, Commerzbank increased its investments in the non-financial sector by 36% to DM 2.4 billion. Significant holdings were Karstadt (25%, reduced to 10% in autumn 1993); Kühnle, Kopp & Kausch (19.9%); Heidelberger Druckmaschinen (13.8%); Turbon International (13%); Salamander (10.9%); Linde (10.4%); Friedrich Grohe (10%); Mineralbrunnen Überkingen-Teinach (10.1%); Schweizer Electronic (10%); Linotype-Hell (6.7%); MAN (6.5%); Thyssen (5%); Hochtief (2.5%) (Commerzbank, Annual Report 1993).

¹³ In 1994 management pointed out that on average, between 1984 and 1994, Commerzbank had been responsible for a fifth of all IPOs in Germany (Commerzbank, Annual Report 1994, p. 24).

office in St. Petersburg. By the end of 1993, Commerzbank was also present in Budapest and Prague. It swiftly entered into a strategic partnership with the Polish Bank Rozwoju Eksportu (also known as BRE-Bank) in 1994, a partnership which was backed up by an initial investment of 21% (Commerzbank, Annual Report 1994). Subsequently, Commerzbank raised its stake in this former state-owned¹⁵ Polish export development bank and owned 72% of it by the end of 2003 (FAZ, 4 September 2004).

Throughout the 1990s, Commerzbank continued its internationalisation and proudly announced that it was building an “ever denser foreign network” (Commerzbank, Annual Report 1996, p. 22). In addition to the bank’s own international branches and representative offices, Commerzbank’s management kept eagerly investing in foreign banks. For example, Commerzbank bought a 20% stake in an Indonesian bank in 1993 and held a 21% investment in Korea International Merchant Bank, which was merged into Korea Exchange Bank (Commerzbank, Annual Report 1993). In 1998, in the midst of the Asian crisis, Commerzbank raised its stake in Korea Exchange Bank (KEB) to just under 30% and participated in two necessary capital increases in the following two years, lifting its stake to 32.6% (Commerzbank, Annual Report 1999).¹⁶

With the appointment of Mehmet Dalman¹⁷ as head of investment banking in 1997, Commerzbank began to concentrate more on securities, especially equities and equity-related products, such as equity derivatives.¹⁸ Dalman was asked to build a global investment bank for Commerzbank after the bank’s failed attempt to takeover Smith New Court in 1995 (Ipsen, International Herald Tribune, 22 July 1995; FAZ, 6 May 1998). He built a global securities business with a common platform for research, origination, distribution and risk management of cash and derivative products (Treanor, The Guardian, 2 October 2004; Commerzbank, Annual Report 1999). Commerzbank enhanced its corporate finance product range through mergers and acquisitions, asset

¹⁴ A more international profile was also reflected in bond underwriting. For example, in 1997 36% of bonds issued by Commerzbank were denominated in currencies other than DM (Commerzbank, Annual Report 1997, p. 32).

¹⁵ Bank Rozwoju Eksportu (BRE) was founded in 1986 as a joint stock company and privatised in 1990 through an IPO (Commerzbank, Annual Report 1994).

¹⁶ Eventually, Commerzbank sold this investment to US private equity investor Lone Star in two tranches in 2003 and 2006 (Börsen-Zeitung, 8 December 2006).

¹⁷ In 2001, he was appointed to the board of managing directors at Commerzbank.

securitisation and structured finance (Commerzbank, Annual Report 1998, p. 25). By the end of 1999, Commerzbank had almost 700 employees in its global equities division in Frankfurt, London, New York and Tokyo, reflecting management's global aspirations during this period (Commerzbank, Annual Report 1999; Hockmann, 2000).

Dalman also pushed for integration of the corporate and investment banking operations – possibly as he expected to have better access to Commerzbank's Mittelstand clients (Treanor, The Guardian, 2 October 2004). At the start of 2000, Commerzbank's entire equity and bond activities, including the derivatives and mergers and acquisitions teams, were brought together in one securities department, which then employed 1,200 people. At the same time, management decided to link investment and commercial banking, in an effort to promote a relationship banking approach (FAZ, 13 June 2001). This project continued well into the year 2001 (Commerzbank, Annual Report 2000 & 2001) and ultimately led to the dissolution of the bank's Anglo-Saxon investment banking activities in London. While management began trimming back its investment banking operations, through reducing staff by 30%, it refocused on the Mittelstand and launched a lending offensive to these firms in 2003 (Commerzbank, Annual Report 2002 & 2003; FAZ, 31 May 2003).

¹⁸ Commerzbank launched its derivatives operations in 1994 with some 100 staff and the declared objective of becoming a leading player in the international derivatives business (Commerzbank, Annual Report 1994, p. 24).

5.5.2.3. Asset Management

Asset management became a separate corporate division when Commerzbank's management reorganised the bank's head office in 1993. At the time, the bank had funds under management of DM 70 billion (i.e. EUR 36 billion). The division comprised Commerzbank Investment Management (CIM), which administered funds for institutional investors and Commerz International Capital Management (CICM), which was active in international portfolio management (Commerzbank, Annual Report 1992 & 1993).

Moreover, Commerzbank owned 39.6% of ADIG (Allgemeine Deutsche Investmentgesellschaft), through which it marketed mutual funds to retail clients. Commerzbank became a shareholder in ADIG in 1951, two years after its establishment by several Bavarian banks as Germany's first asset management company. After lengthy negotiations, Commerzbank became ADIG's majority shareholder with a stake of 85.4% in 1999 (Börsen-Zeitung, 2 February 1999; Börsen-Zeitung, 29 July 1999). Although management initially planned to develop ADIG as a brand name for the German retail fund industry, it was merged into Cominvest Asset Management in 2002.

The creation of Cominvest Asset Management in 2002 resulted from a restructuring programme which began at the start of 2001. Parts of the previously independent portfolio management and research activities in Germany were combined to improve efficiency. These restructuring measures took place against the background of a difficult market environment and net outflows from its funds following the end of the dotcom era. Administrative and personnel costs had to be adjusted to the significantly lower value of assets under management (FAZ, 10 April 2002).

During the phase of booming equity markets in the late 1990s, assets under managed also soared at Commerzbank, peaking in 1999 when it had funds under management of EUR 140 billion. The first time Commerzbank disclosed profitability figures for its asset management unit was in 2000: it delivered a net loss of EUR 39 million.¹⁹ The following year the loss widened to EUR 165 million. 2,351 employees contributed to a cost income ratio of 142% at the time, revealing the need for the aforementioned restructuring measures. Along

with the reorganisation of its domestic asset management units and the streamlining of product ranges, Commerzbank began also cutting back its international engagements outside Europe in 2001.

Throughout the 1990s, Commerzbank had internationalised its asset management operations, mainly through acquisitions. In 1993 it acquired Paris-based Caisse Centrale de Réescompte (CCR), which at the time employed 45 people and managed DM 5.8 billion in 1993 (Commerzbank, Annual Report 1993). CCR was particularly strong as a manager of money-market funds, but as of 1998 it also gained a reputation in the French market for its “value” management approach in equities. Due to the funds’ solid performance and a good inflow of new funds, CCR managed assets worth EUR 12.8 billion, at the end of 2003 (Commerzbank, Annual Report 2003).

While the acquisition of CCR was a “lucky buy”, Commerzbank’s endeavours in the Anglo-Saxon asset management world were less fortunate. In 1995, Commerzbank internationalised its asset management through two acquisitions. In the UK, it bought Jupiter International with DM 11.6 billion funds under management and a focus on investing in international equities. Although most of Jupiter’s funds performed well and the company enjoyed a strong inflow²⁰ of new funds, it was reported that Jupiter was not a very profitable investment for Commerzbank due to the high compensation schemes of its fund managers and founder John Duffield (FAZ, 28 February 2002).

In the same year as it bought Jupiter, Commerzbank also took over the small US asset manager Martingale Asset Management, which mainly invested in US equities. Two years later Commerzbank was able to strengthen its position in the US-market through the acquisition of Montgomery Asset Management in San Francisco. In 1997, Montgomery managed USD 9.4 billion, mainly retail funds for some 320,000 retail customers (Commerzbank, Annual Report 1997).

¹⁹ In 2000 Commerzbank managed EUR 135 billion of assets. 65% were funds for institutional investors and 35% were publicly-offered funds and funds for retail customers. 54% were equities and 28% fixed income, 15% money market funds and 3% real estate funds (Commerzbank, Annual Report 2000, p. 19).

²⁰ By the end-2003, Jupiter managed EUR 15 billion.

Montgomery's assets declined in the following years and were down to USD 7.5 billion by the end of 2001. Although falling equity markets in 2001 certainly accounted for a substantial part of this decline, it is obvious that Montgomery also found it difficult to attract new funds. Given that Montgomery managed funds for retail clients, part of the problem of this outflow of money was that Commerzbank did not operate an established distribution network in the USA.

Despite renewed distribution efforts and 20% lower costs, Commerzbank's management decided to sell Montgomery Asset Management to Wells Capital at the end of 2002 (Commerzbank, Annual Report 2001). Martingale was also sold through a management buy-out in the same year (Pensions and Investments, 16 September 2002). The disposal of these two units marked the complete withdrawal of Commerzbank's asset-management group from the US, in accordance with management's plan to focus on Europe.

With the exception of its brief Italian²¹ and Czech²² intermezzos, Commerzbank kept all of its European asset management units intact. In Spain, where it had had a presence since 2000, Commerzbank remained active via its small Madrid-based subsidiary Afina, which broke-even at year-end 2001. In Poland, ADIG continued its joint venture with BRE-Bank, which had been established in 1996 (Commerzbank, Annual Reports 2000 & 2001).

Commerzbank's decision to scale back its asset management operations and to refocus on a few European markets paid off. Although assets under management were a mere EUR 83.3 billion in 2003, 40% less than in 1999, the bank's asset management division was turned around and delivered an operating profit of EUR 90 million, contributing 16% to the group's total operating income. With capital employed totalling EUR 639 million, this operating profit translated into a return on equity of 14.1% and the cost income ratio stood at 79.3% (Commerzbank, Annual Report 2003).

²¹ Management said the disposal of the Italian US operations in 2003 "removed a sizeable burden from the cost side" (Commerzbank, Annual Report 2003, p. 24).

²² The asset management unit in Prague was set up in 1999 and closed down again in 2001.

5.5.2.4. Retail Banking

In 1993, Commerzbank operated 1,006 branches worldwide and had 3.4 million clients. At the time, the number of East German clients was 300,000, served by 2,150 employees in 113 branches, with the number of branches still growing. Management explained that its strategy in its retail customer business²³ was to manage its clients' assets in an all-inclusive approach, while improving the bank's results through greater standardisation of processes (Commerzbank, Annual Report 1993, p. 21).

Throughout the period under review, Commerzbank remained committed to a bancassurance concept (Allfinanz). Thus, it offered a broad range of financial services, including insurance and mortgage savings products to its retail clients (Commerzbank, Annual Report 1993). Initially, Commerzbank extended its all-round financing approach through cooperation agreements with the building society Leonberger Bausparkasse and insurance company DBV in 1988 (Commerzbank, Annual Report 1992; Schneider, *Börsen-Zeitung*, 17 February 1995).²⁴ This bancassurance strategy reduced Commerzbank's dependence on net interest income from retail banking as the sale of third-party savings contracts and insurance policies generates commission income.

The cooperation with DBV-Winterthur and Leonberger Bausparkasse came to an end when the Italian insurer Generali acquired a 5% stake in Commerzbank shares in 1998.²⁵ Subsequently, Commerzbank became the exclusive German partner of AMB, Generali's German subsidiary (Sen, Metzler Equity Research, 10 November 1998). As the building society Badenia Bausparkasse belonged to AMB, Commerzbank also parted ways with Leonberger Bausparkasse.²⁶ In addition to life insurance policies and mortgage savings schemes, Commerzbank also opened its distribution network to other third party funds in 2001, pursuing an open architecture strategy (FAZ, 14 March 2002; Bender, FT, 11 October 2004). By the end of 2003, half of the mutual funds (retail funds) sold by Commerzbank were not

²³ Until 1999 Commerzbank's retail banking segment was part of the group's domestic banking segment.

²⁴ Commerzbank had acquired 40% of the building society Leonberger Bausparkasse in 1988. DBV merged with the Swiss insurer Winterthur to create DBV-Winterthur in 1995 (Schneider, *Börsen-Zeitung*, 17 February 1995).

²⁵ Generali increased its stake in Commerzbank to almost 10% in 2000 (Hoymann, Metzler Equity Research, 4 September 2000).

²⁶ Commerzbank sold its stake in Leonberger Bausparkasse to Württembergische Versicherungsgruppe in 1998 (*Börsen-Zeitung*, 10 December 1998).

from its own asset management arm, but from some other fund management company (Commerzbank, Annual Report 2003).

AMB and Commerzbank intensified their cooperation by further integrating their distribution expertise in 2000. Around 850 insurance and mortgage specialists became part of the Commerzbank branch network. In return, banking centres were established at 250 insurance agencies, offering banking products to insurance policyholders. Besides the all-round financing approach, which was a cornerstone of its distribution strategy in retail banking Commerzbank also made use of telephone banking²⁷ and direct banking.

Commerzbank began its direct banking services in early 1994, through comdirect bank. Its initial approach was to offer retail customers an investment account and discount brokerage facilities for securities trading. Prices could be kept low compared to traditional branch banking services as customers were not offered advice. The range of products was extended in the following years and as of 1996, comdirect began to offer online banking services. Four years after its formation it reached break-even point, with a total of 577,000 customers (Comdirect, Annual Report 2001).

In 2000, Commerzbank decided to float comdirect by placing 20% of its shares on the market. In the following two years comdirect expanded into the United Kingdom, France and Italy. However, falling stock markets caused a decline in commission income and comdirect reacted with a far-reaching cost-cutting programme that concentrated its activities on the UK and German markets. In Germany, comdirect enjoyed the position of market leader in online banking and the reputation as having the best online banking website (Commerzbank, Annual Report 2001). Despite lower revenues, comdirect was the only German online broker to report a profit from ordinary activities in 2002 (EUR 75 million, after a loss of EUR 752 million in the previous year), proving that it had achieved the necessary size to operate a viable business model.

For several years much of Commerzbank's client growth came from comdirect - for example, nearly all of Commerzbank's 110,000 new clients in 1997 were gained via its direct banking arm. Other attempts to differentiate

²⁷ From 1994 onwards, Commerzbank offered a telephone banking service called Comphone in Germany. By end-1996, 200,000 clients used this service.

Commerzbank's distribution channels were less successful. In 1997, Commerzbank opened its first of a series of Commerzbank shops in a self-service store. These branches were open longer hours and on Saturdays. By the end of 1998, Commerzbank operated 26 of these outlets, which served 25,000 customers. However, they were closed as part of the cost-cutting drive launched in 2001 as they were not profitable enough (Commerzbank, Annual Report 2001).

Commerzbank's group-wide cost-reduction measures also affected the bank's retail banking operations. The number of domestic branches was reduced to 724 by end-2003, down from a peak of 939 in 1999. Moreover, branch personnel were cut by nearly 1,700 between 2001 and 2003. These measures contributed to a 20% improvement in sales productivity between 2001 and 2003 (Blessing, 2004). At the same time, Commerzbank tried to increase the number of online customers, which amounted to 420,000 in 2001 - excluding comdirect's 649,000 clients.²⁸

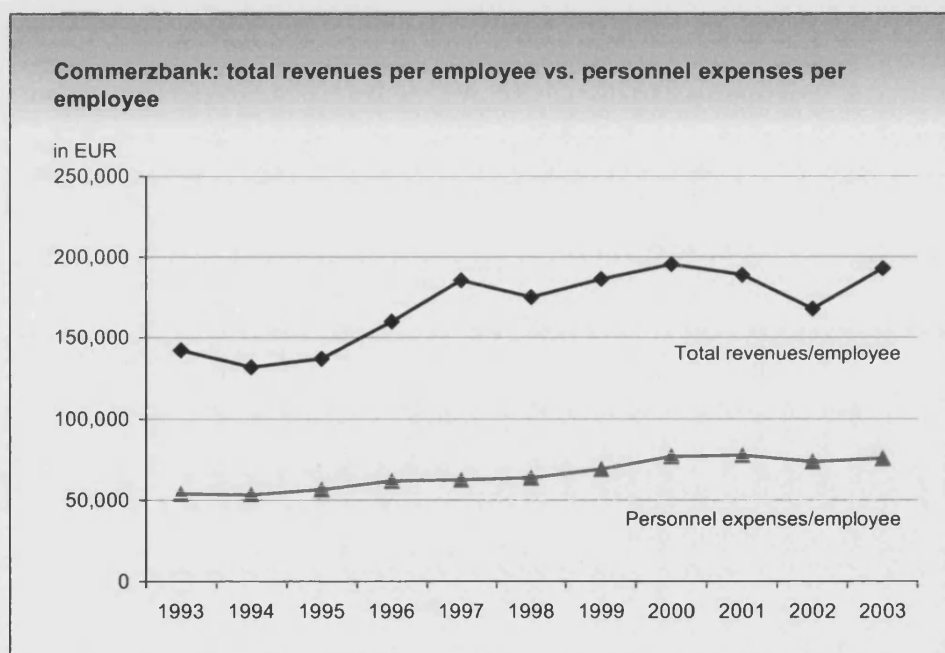
The reviewed differentiation in retail banking included an attempt to accelerate growth in private banking, which Commerzbank had stepped up in an initial effort in 1997, after many years of low profile existence within the bank. In 1997, advisory teams were set up in six of Germany's largest cities to serve the estimated 40,000 affluent private-banking clients among its existing customers. Within five years, Commerzbank expanded its private banking services to 20 branches where it had private-banking teams.

Following on from its "play to win" restructuring programme in retail banking which was launched in 2002, management introduced a "grow to win" strategy for retail banking in 2003 and proclaimed an ROE target of 17%. As a first sign of this renewed growth strategy in retail banking, Commerzbank bought SchmidtBank with 350,000 retail customers and 70 branches (Blessing, 2004). Subsequently, Commerzbank gradually expanded its branch network and gave retail banking a high priority in the following years.

²⁸ Alongside comdirect, Commerzbank itself began offering its banking services via the internet in 1997.

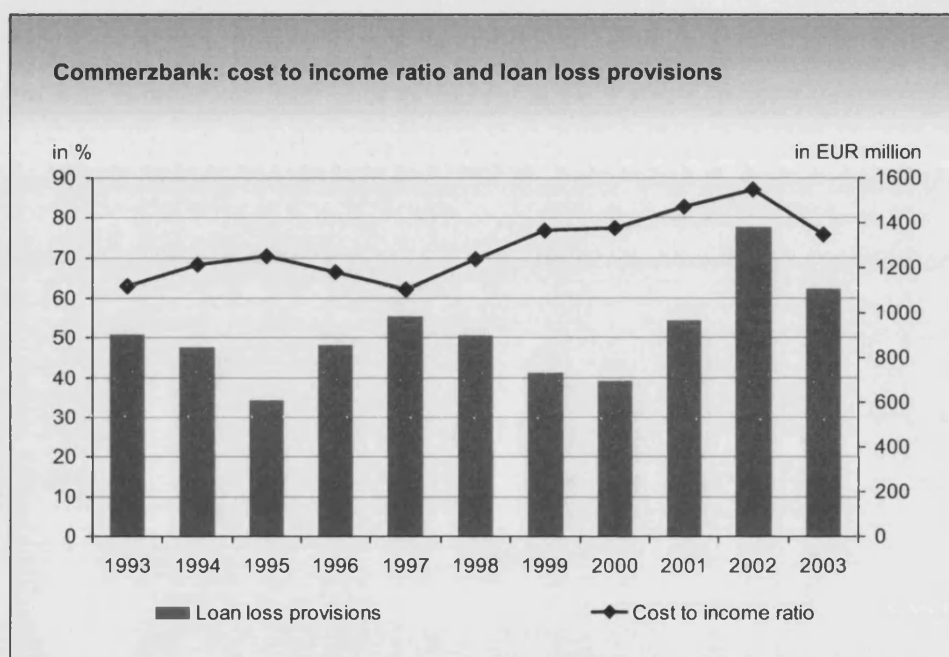
5.5.3. Cost and Risk Management

Commerzbank initially failed - and subsequently avoided - buying an Anglo-Saxon investment bank, unlike its German peers, Deutsche Bank and Dresdner Bank. Thus, the bank's risk management was spared the challenges of integrating a bank of notable size (Ipsen, *International Herald Tribune*, 22 July 1995; Wittkowski, *Börsen-Zeitung*, 11 October 1997; FAZ, 7 November 1997; FAZ, 6 May 1998). Even the process of becoming the majority shareholder in Poland's BRE-Bank was done in slow and cautious mode. Yet, the acquisitions in the field of asset management, especially the takeover of Jupiter, gave Commerzbank's management a flavour of what its two German rivals went through after they bought Anglo-Saxon investment banks.



The internationalisation of Commerzbank's asset management operations in 1995 through two acquisitions contributed to a rise in personnel expenses per employee of 7-8% p.a. in the following two years (Pretzlik & Targett, FT, 3 June 2000). Equally striking was the impact of management's decision to move into investment banking through an organic growth strategy, with expenses per employee rising by 9% (y-o-y) in 1999 and by 12% (y-o-y) in 2000.

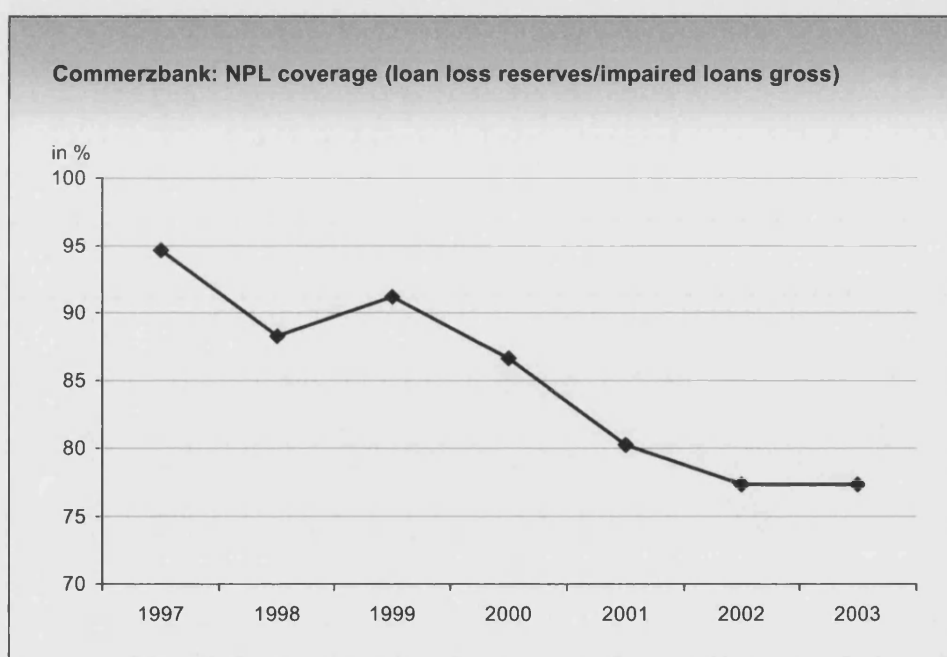
During the period under review, Commerzbank's total personnel costs per employee rose by a compound annual growth rate of 3.5%, compared to an average increase of total revenues per employee by just 3.1% p.a. The number of employees was 28,241 in 1993 and peaked at 39,481 in 2001. In the following two years, Commerzbank's workforce declined again to 32,377. Although the deconsolidation of Rheinhyp, the mortgage-banking arm, accounted for a headcount reduction of 867 employees in 2002, the sharp fall in employees between 2001 and 2003 was largely due to layoffs (Commerzbank, presentation, 6 November 2001).



As part of the bank's major restructuring program, CB 21²⁹, management cut around 6,200 jobs, i.e. 16% of its staff, between 2001 and 2003. These redundancies affected most areas of the bank, yet in relative terms, investment banking was hardest hit. The CB 21 included merging the corporate and investment banking activities, thereby effectively closing down the investment banking operations in London. Furthermore, it was decided to combine retail banking and asset management in one division. Management expected from CB 21 to improve the bank's pre-tax profit by roughly EUR 1 billion until 2003, helping the bank to achieve its long-standing net profit target of a 15% return on equity (Commerzbank, Annual Report 2000).

²⁹ "CB 21 – Commerzbank in the 21st century" (Commerzbank, Annual Report 2000, p. 5).

Despite these substantial headcount reductions, Commerzbank's cost income ratio was still 76% in 2003, compared to 63% in 1993.³⁰ The persistently high cost income ratio stemmed from diverse administrative costs, such as expenses for information technology and office space (Commerzbank, Annual Reports 2002 & 2003). Commerzbank's investments for internationalisation and expansion into investment banking contributed to this development. Initially, revenues lagged behind these high investments, driving up the cost income ratio. By the time these investments were expected to translate into higher revenues, an economic downturn had begun and revenues were falling faster than expenses could be scaled back (Hoymann, Metzler Equity Research, 6 February 2003). On average, Commerzbank's cost-income ratio stood at 73% during the decade analysed.



While personnel costs averaged 44% and administrative spending 28% of Commerzbank's total operating expenses between 1993 and 2003, loan loss expenses made up an average of 19% of the bank's cost base. During the years analysed, loan loss provisions ate up 30% of the bank's net interest income. Even after the deconsolidation of Rheinhyp in 2002, loan loss provisions exceeded EUR 1 billion, thereby still eating up 44% of net interest

income of that year.³¹ The high loan loss provisions largely originated from its German clientele. Commerzbank's strong exposure to the German economy, which was slipping into recession in 2002/03 and the bank's focus on Mittelstand companies that were going through the trough, was reflected in a deteriorating loan portfolio quality.

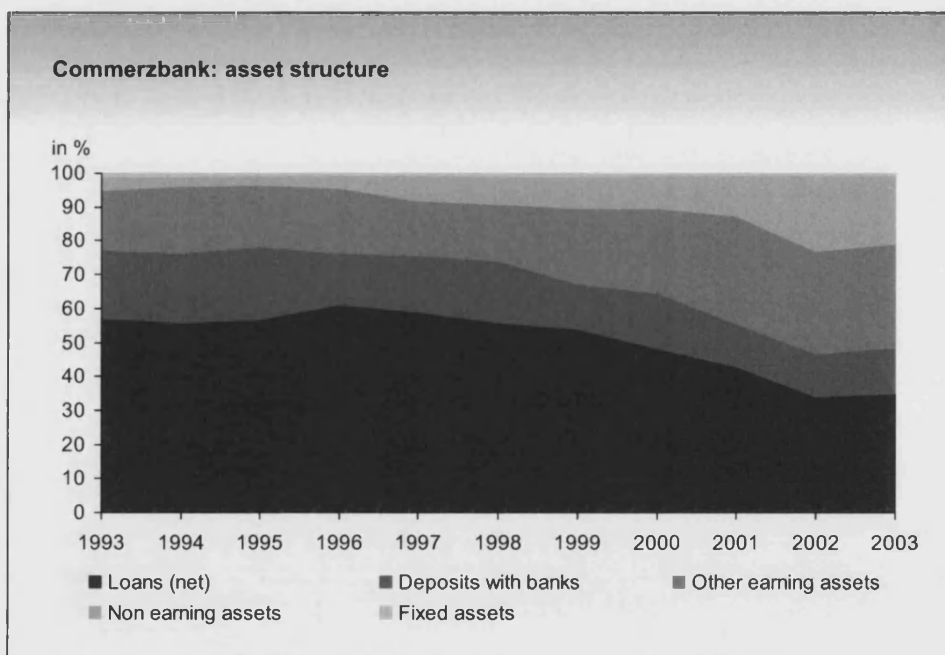
Besides the loan portfolio exposure to Germany, the bank's diverse investments were also largely held in German companies. Thus, Commerzbank had to write down EUR 2.3 billion on its portfolio of financial assets and participations in 2003. These value adjustments, along with another high loan loss provision of EUR 1.1 billion and personnel cuts were a necessary clean sweep, which paved the way for renewed growth in the following years. CEO Müller made it clear, after the substantial reduction of expenses in 2002 and 2003, that further cost cuts could not be achieved if the bank wanted to grow again (Börsen-Zeitung, 19 February 2004).

³⁰ Management planned to achieve a cost income ratio of 60 to 62% in 2000 (Wittkowski, Börsen-Zeitung, 11 October 1997).

³¹ In 2003 40% of Commerzbank's net interest income was still eaten up by provisions for loan losses.

5.5.4. Asset-Liability Structure

After a review of its risk management approach in 1993, Commerzbank concluded that the main metric used for financial management of the bank should be the return on risk capital. "It is this yield which determines how funds are allocated between the various banking departments and, within these units, to the various product groups, right down to the steering of individual transactions" (Commerzbank, Annual Report 1993, p. 20). This statement suggests that Commerzbank's management had a clear understanding of the scarcity of capital and the implicit cost of capital. That said, Commerzbank's frequent capital increases during the period analysed, give the impression that management viewed the capital market as a self-service organisation. During the decade under review, Commerzbank raised a total of EUR 4.4 billion in seven separate share issues. That was more than its shareholders' equity had been in 1993.³² The need for fresh capital becomes evident from an analysis of Commerzbank's rather expansive lending policy between 1993 and 2000.

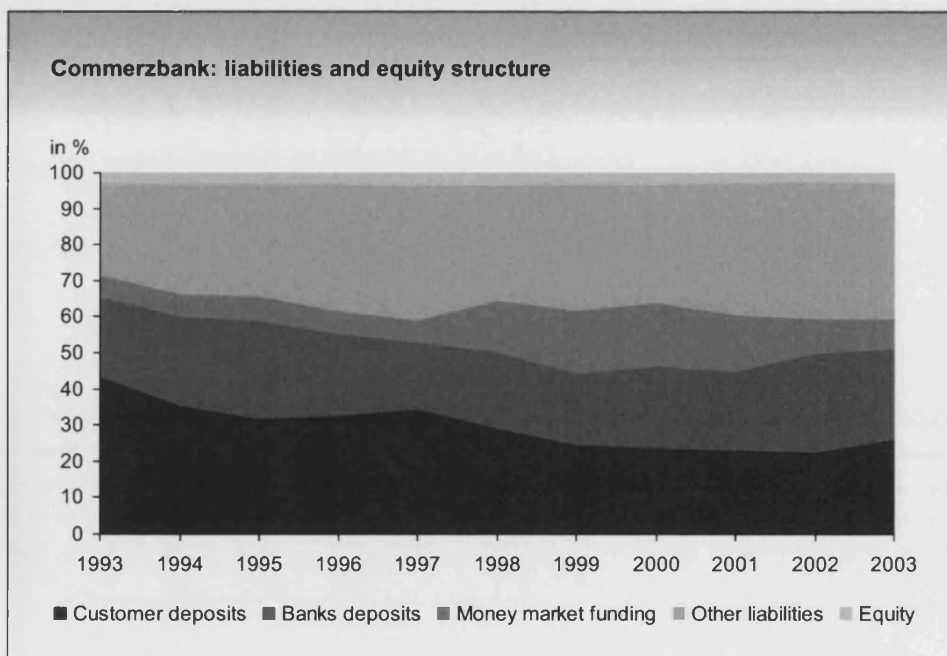


In 1993 Commerzbank had EUR 82 billion of loans outstanding, which rose to a peak of EUR 220 billion in 2000. During that seven-year period, the bank's

³² Shareholders' equity was EUR 4.1 billion at the end of 1993.

loan portfolio grew by 15% p.a. on average, while its tier 1 ratio averaged just 5.7%. Commerzbank's tier 1 ratio stood at 4.4% in 1993 and remained relatively low throughout the first half of the decade. Following two large capital increases in 1997 and 1998, the bank's tier 1 ratio rose above 6%. Commerzbank's loan portfolio declined to EUR 133 billion again in 2003 – mainly because of the deconsolidation of Rheinhyp in 2002 and the securitisation of risks - implying an average growth rate of 5% p.a. for the period 1993 to 2003.

Besides its customer lending spree, Commerzbank also increasingly deposited more money with other banks, although not as much as it received from other banks. In 1993, the ratio of deposits with banks versus deposits from banks was still nearly 1:1, whereas in 2003 it was around 1:2. The larger proportion of funds from other banks deposited at Commerzbank could have become a major challenge for Commerzbank's liquidity management if these institutions had withdrawn their short-term liquidity. The high volume of interbank business was due to Commerzbank's increased activities in securities lending and in securities transactions, involving, for example, repurchase agreements (repos) (Commerzbank, Annual Report 2000, p. 8).

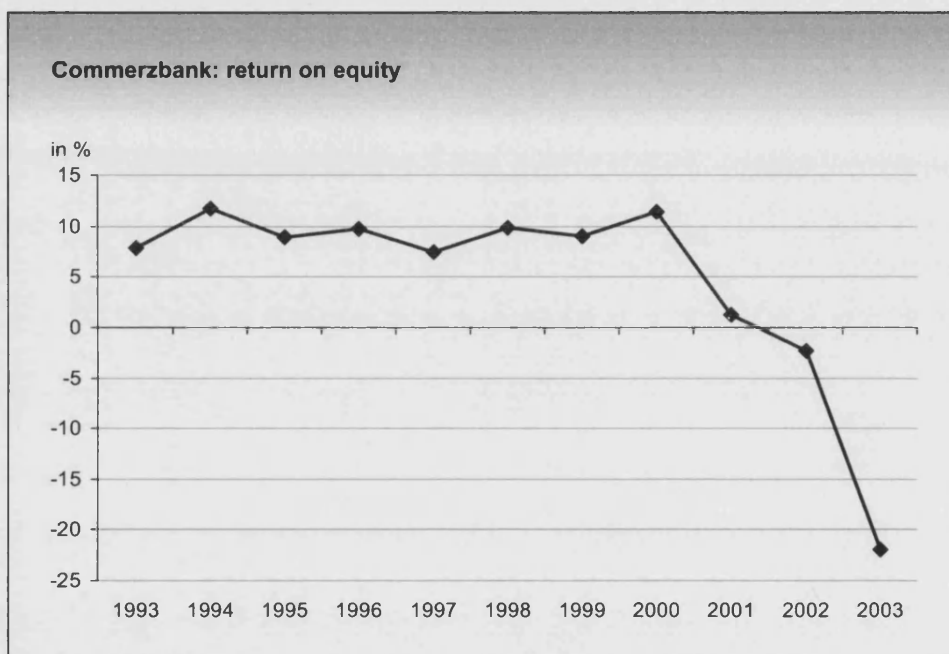


The most striking structural shift on the asset side came from Commerzbank's non-earning assets. While in 1993 non-earning assets made up just 4% of the group's total assets, the figure rose to 20% in 2003. These non-earning assets were largely trading-related assets, primarily financial derivative instruments with positive market values (Commerzbank, Annual Report 2002, p. 131). Equally, Commerzbank's trading activities were reflected on the liabilities side, where derivative financial instruments with a negative fair value were shown. The growth of these trading and derivative-related items originated from Commerzbank's attempt to build an investment bank, with trading and derivative products playing a pivotal role in this effort.

The most remarkable structural change on the balance sheet was the continuous decline in customer deposits relative to total liabilities and equity. In 1993, 44% of the bank's funding still came from customer deposits. During the following decade, the proportion of customer deposits declined to 26% in 2003. On average 30% of funding stemmed from customer deposits, compared to 23% from other banks' deposits. As the weak tier 1 ratio suggests, Commerzbank's shareholders equity base was relatively lean and made up 2.9% on average of the bank's funding between 1993 and 2003.

5.5.5. Profitability

Despite Commerzbank's lean equity base, its after-tax ROE still averaged just 4.8% between 1993 and 2003. Certainly, this did not cover the bank's undisclosed cost of equity, and was far below management's targets. In 1994, Commerzbank announced an after-tax return on equity target of 9.5-10% for the next five years (FAZ, 16 April 1994). However, by 1996 CEO Kohlhaussen was declaring that the bank's return on equity target was 15% after taxes (FAZ, 28 October 1996). This upward revision of the target came after Commerzbank delivered a ROE of 9.8% in 1996, without any major extraordinary disposal gains.



In contrast to the 1996 results, non-operating items affected Commerzbank's net profit in all other years between 1993 and 2003. In particular, the massive net loss of EUR 2.2 billion in 2003 and EUR 269 million in the previous year reduced the average return in the period analysed, even though the bank boosted its profits in most years under review through disposal gains. For example, the sale of a 15% shareholding in Karstadt and the disposal of 37.5% of the insurer DBV largely contributed to a non-operating income of EUR 534 million in 1994.

Another major disposal was the partial IPO of comdirect in 2000, which accounted for the EUR 1.2 billion extraordinary gain in 2000. Taking into account these numerous disposal gains, the pre-tax return on equity was 3.7% higher for the years 1993 to 2001 and averaged 13.3% on a pre-tax level and 8.7% on an after-tax level, still falling short of the declared profitability targets. Commerzbank did not reach its ROE target of 15% in a single year between 1993 and 2003 and its highest return on equity of 11.7% (1995) was only achieved through a substantial disposal gain of EUR 534 million.

Commerzbank's total operating income grew by a compound annual growth rate of 4.5%, while its total operating expenses rose on average by 5.4% p.a.. Obviously, if costs rise faster than revenues this is not conducive to a company's profitability. Commerzbank's higher costs and the related decline of profitability were attributable partly to provisions for loan losses, and to an even greater extent to mounting administrative and other operating expenses, as the continuously rising cost income ratio demonstrates. This suggests that part of Commerzbank's problems lay within its organisational structure. More specifically, the bank's branch network was inefficiently structured, the costs for maintaining a relatively large international network were too high and the bank's IT infrastructure lacked coherence. An additional reason for Commerzbank's weak profitability was the erosion of its net interest margin. The bank's net interest margin fell from 2.11% in 1993 to 0.89% in 2003, while the total loan portfolio increased by 63% (1993 vs. 2003). Thus, the bank's loan portfolio grew increasingly less profitable.

5.5.6. Conclusion

The analysis of Commerzbank's corporate strategy between 1993 and 2003 leaves the impression of an institution that eventually benefited from being a latecomer. This German commercial bank with a substantial retail banking network achieved very little that is likely to find its way into the annals of strategic bank management history, but it still scored some minor successes. For example, it built the country's largest online bank that survived the dotcom boom and Commerzbank became a well-positioned player on the German asset management market through the establishment of cominvest.

Arguably, the bank's two greatest successes were its failure in investment banking and its continuous commitment to retail banking in Germany. With hindsight, the bank's late start in investment banking, turned out to be a competitive advantage with the Mittelstand. Commerzbank wanted, but failed, to buy an investment bank and was not ready to pay sums that management considered unjustifiable. Thus, the bank with the yellow logo gained capital market expertise by hiring staff and organically building a unit that operated out of London and somewhat resembled an investment bank, providing the whole range of transaction services.

When the capital markets turned down in 2000, Commerzbank was still in the process of expanding its investment banking operations and could therefore react swiftly to the altered macroeconomic environment. As it had not lost touch with its clientele of small and medium-sized enterprises, it could credibly reconnect to this segment, something which some of its peers found difficult as they had neglected the Mittelstand while indulging in international investment banking.

Moreover, Commerzbank remained committed to retail banking in Germany throughout the 1990s. Despite poor profitability, there was little reason for its retail clients to feel abandoned during a phase of investment banking and internationalisation hype. Commerzbank's decision to cooperate in the field of bancassurance, instead of buying or founding its own insurance company, helped avoid balance sheet risks from this business and still allowed to provide the services expected by its retail clients.

Apart from these small successes which, taken together, form an uninspiring bank, Commerzbank's greatest success was its slowness, which with hindsight could be considered to be the outcome of a thoughtful strategy. Although it remains hypothetical, one possible reason for Commerzbank's slow, not to say cumbersome, strategic moves was the relative stability of the management team, with Martin Kohlhaussen as the bank's CEO from 1991 to 2001. Kohlhaussen ruled unchallenged and none of his management colleagues seemed to feel the need to undertake attention-grabbing initiatives.

This management stability is also reflected in Kohlhaussen's effort to keep the bank independent. For this purpose, he entered into various European cooperation agreements in the early 1990s. Several years later, he regarded a cross-border merger between Commerzbank and another European institute as unlikely. More specifically, he did not believe in any mega-merger and showed great scepticism about cost synergies from such deals (FAZ, 13. March 2000).³³ Towards the end of his tenure, Kohlhaussen remarked that nationalism regarding banking matters in Europe seemed much more prevalent than he had imagined a few years ago (FAZ, 13. March 2000). This sobering view of European financial integration was shared by his successor Müller (FAZ, 13 Juni 2001).

³³ The confirmed talks between Dresdner Bank and Commerzbank in July 2000 were primarily a reaction to demands made by Commerzbank's largest shareholder at the time, Cobra, which owned 17% of the bank in May 2000 (FAZ, 18 May 2000; Major, Pretzlik & Ratner, FT, 17 June 2000; Major, FT, 20 June 2000; FAZ, 14 July 2000; FAZ, 19 July 2000; FAZ, 20 July 2000).

5.6. Barclays plc

5.6.1. Introduction and Status Quo in 1993

Barclays epitomised British banking for most of the twentieth century. The bank was closely associated with the British Empire and thereafter with the Commonwealth, which earned it the title of the "empire's bank" (Rogers, 1999, pp. 67-68). Founded by Quaker families¹ in 1896, Barclays emerged as Britain's largest bank in the 1950s - a position it spent the 1990s trying not to lose to National Westminster (Vander Weyer, 2000; Ackrill & Hannah, 2001). As a result of fierce competition for size, Barclays became rather improvident with its lending policy throughout the 1980s.²

This growth strategy culminated in a strong rise in loan loss provisions and the bank's first net loss in 1992, which led to the resignation of John Quinton, who had held the joint position as the group's chairman and chief executive. Andrew Buxton, an offspring of one of the Barclays' founding families, succeeded John Quinton as chairman and also became the bank's chief executive on 1 January 1993. However, in response to pressure from shareholders separation of these two posts was brought about and Barclays started searching for a new a chief executive. Andrew Buxton remained Barclays' chairman until 1999, when he was succeeded by Peter Middleton (chairman until 2004).

Finally, in autumn 1993 Barclays named an outsider, Martin Taylor, as the company's new chief executive. Taylor joined Barclays from Courtaulds Textiles, where he had demonstrated his managerial skills as the company's chief executive. Prior to Courtaulds Textiles, he had worked as a journalist with the Financial Times (Hosking, *The Independent*, 22 August 1993). He was appointed to the board on 1 November 1993 and officially became the group's chief executive on 1 January 1994. Despite Taylor's initial intention of

¹ Barclays was formed as a new joint stock bank through the merger of 20 private banks in the London area (Rogers, 1999, p. 70). However, the very beginnings of Barclays can be traced back to several goldsmith-bankers in the late 17th century. In 1690, John Freame and his partner Thomas Gould set up a goldsmith-bank in Lombard Street. The name Barclay became associated with the bank when John Freame's son-in-law, James Barclay, became a partner in 1736 (Source: Barclays Group Archives).

² Barclays raised GBP 921 million in new capital in 1988. Between 1990 and 1992 Barclays took charges of over GBP 4 billion for bad and doubtful debts. In 1992, Barclays had to provision for nearly GBP 800 million of bad lending to the property sector (FT, 5 March 1993).

staying at Barclays for seven years (interview Martin Taylor)³ he stepped down just over four years later in October 1998. The reason⁴ why he took this decision was the lack of support from some board members for his strategic views. More specifically, it became obvious to him that the bank's chairman, Buxton, would not keep his promises (interview Martin Taylor).⁵

Taylor was succeeded by Middleton as an interim CEO. Middleton had joined Barclays in 1991 as group deputy chairman after nearly 30 years as an adviser at the Treasury. In 1999, Michael O'Neill a former Bank of America executive was named as chief executive but had to resign on his first day for health reasons.⁶ Eventually, Matthew Barrett joined Barclays as chief executive officer from Bank of Montreal and held that position until 2004.

Taylor's legacy of restructuring measures helped Barrett to refocus Barclays on growing revenues. During his time as CEO Barrett could take advantage of a reduced cost base, a more nimble organisation, improved risk management and a flourishing British economy. Therefore, the period analysed (1993 to 2003) can be divided into two phases: the cost-cutting and trimming phase under Taylor and the expansion phase during Barrett's time.

Clearly, the arrival of Taylor in 1993 had a much greater immediate impact for

³ Publicly Martin Taylor said he planned to stay for ten years, but he did not want people to tick off the days to his departure (interview Martin Taylor; Cohen & Gapper, FT, 20 August 1993).

⁴ At the time, it was suggested that Taylor stepped down as Barclays' CEO for four reasons: First, the choice of a controversial public auction for the sale of BZW's equities and advisory business in 1997 had been frowned upon. Second, a disagreement between Martin Taylor and Sir Andrew Large about his role as the bank's executive deputy chairman emerged in May 1998. Third, the Russian crisis in August 1998, in which Barclays Capital lost GBP 250 million, added fuel to the fire. And, finally, the October 1998 board meeting in New York at which Martin Taylor suggested a break-up of the bank into a retail and a corporate bank led to an *éclair* (Dixon, FT, 30 November 1998; Vander Weyer, 2000).

⁵ At the time, it was reported that Taylor wanted to break up the bank into a retail arm and a corporate arm (Dixon, FT, 30 November 1998; The Economist, 18 November 2000; Vander Weyer, 2000). This was not confirmed by Taylor during the interview for this research. He told the board of directors in a meeting in New York: "I wanted to look at other ways of handling the Barclays Capital risk position and we were looking at merging with Paribas and all sorts of other things and the board, the chairman and one of the directors simply did not want to talk about it. Their view was we don't want to hear about any ideas and my view was that I was not happy staying in a situation where I was not even able to propose courses of action. The board meeting in New York, which was October 1998, actually crystallised this issue and I said to the board I'm extremely unhappy and I think the board is ducking its responsibility and is not behaving as a board and I am going to consider my position. I went home the next week and I went to see the chairman and said to the chairman: 'Look I am very unhappy with the situation, I can't possibly stay two more years. I find this, I mean, I had to communicate to shareholders and you ask me to lie to them'. So, I said 'Do you want me to go now?' He said 'No'. I said, o.k. 'I will go at the end of next year, 1999, but I want you to promise that you let me manage Barclays Capital and I want you to promise to get rid of one director because he is causing trouble on board and I can't work with him. Get rid of him. We have a deal. You help me let me manage Barclays Capital and I will stay for one more year.' He said 'Fine that is a solution'. He talked to the director. He did not go and he then interfered the next week with a very major Barclays Capital issue. So, I said to him, 'I am sorry, I am out off here. You have twice broken my agreements with you. I can't stay'" (interview Martin Taylor).

⁶ Michael O'Neill seemed to have recovered from cardiac arrhythmia when he accepted the job offer as chairman and chief executive officer of Bank of Hawaii on 3 November 2000. He stayed with Bank of Hawaii until 31 August 2004 (source: Bank of Hawaii press releases).

Barclays than the advent of the European Common Market especially as Barclays had already positioned itself as the most pro-European British bank through two acquisitions on the continent in 1990. Among its UK peers, Barclays was the first to make inroads into the European continent in the late 1980s and pursued the most aggressive, acquisition-led European strategy. In 1989, Barclays' managers explained that they considered Barclays to be "the best-represented European bank, with operations in 11 out of 12 of the EC countries" (Landau, JP, 11 October 1989). At the time, Alex Dyce of the bank's strategic planning department pointed out that the European Common Market changed the perspective and that Barclays' 24% of the UK market represented only 2% of the European market, which would allow for significant growth opportunities (Landau, JP, 11 October 1989).

In France, where the bank has been present since 1915, it bought Européenne de Banque for FRF 1.5 billion (GBP 153 million) in 1990, thereby doubling its retail market presence to more than 70 offices and 100,000 customers (Lascelles, FT, 29 December 1990). Until 1990, Barclays' German operations primarily served the corporate sector. Following the acquisition of private bank Merck Fink in 1990 for an estimated DM 600 million it also expanded into the German market for high-net-worth individuals (*Börsen-Zeitung*, 4 July 1995). In Spain Barclays opened its first branch in 1974 and developed a retail banking network long before the European Common Market was launched, and gained an additional 38 branches through the acquisition Banco de Valladolid in 1981 (*The Economist*, 14 March 1981).

Upon his arrival, Taylor's analysis of Barclays' European operations concluded that it owned one very good bank in Spain and one very bad bank in France (interview Martin Taylor). Moreover, there were start-ups in Portugal and Greece and Merck Finck, which Barclays should have never bought according to Taylor, as it did not know how to manage it. He referred to it as a terrible mistake and remarked that the only thing Merck Finck had in common with Barclays was "arrogance and self-delusion" (interview Martin Taylor). Taylor also held the view that most members of Barclays senior management did not have a clear view what the European Common Market meant and showed little interest in this subject.

Despite Barclays' undifferentiated European expansion strategy prior to the

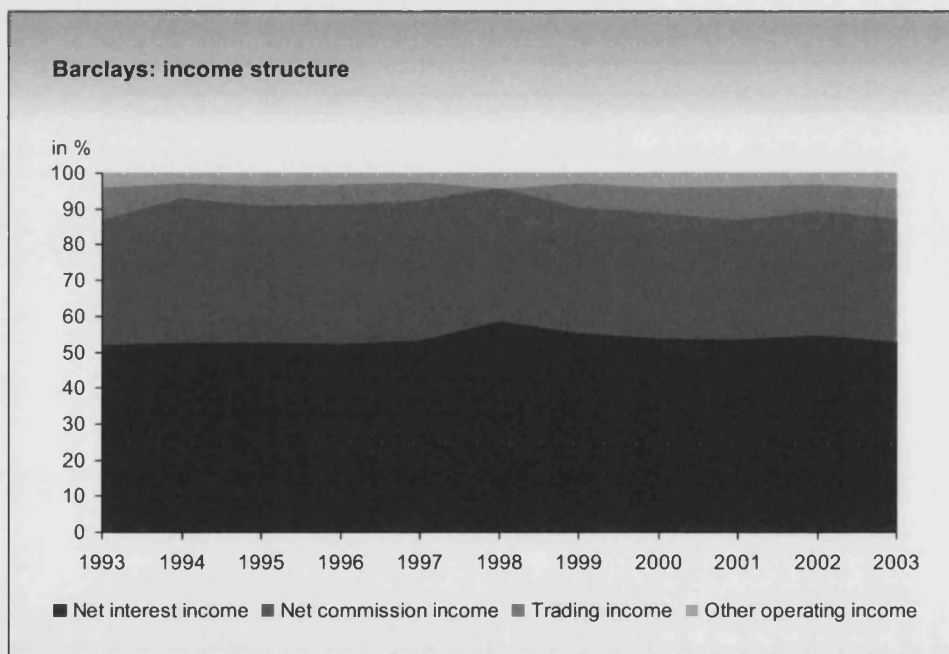
completion of the Single Market, the bank's retail operations ultimately focused on just few countries, namely Spain, France and, of course, Britain. Barclays strengthened its domestic position in retail banking and broadened its product range. In contrast, Barclays' corporate banking initially started with a broad product range, predominantly in the UK and subsequently internationalised, while concentrating on debt products. The development of the bank's revenues will be analysed in the following section.

5.6.2. Income Structure

5.6.2.1. Structural Overview

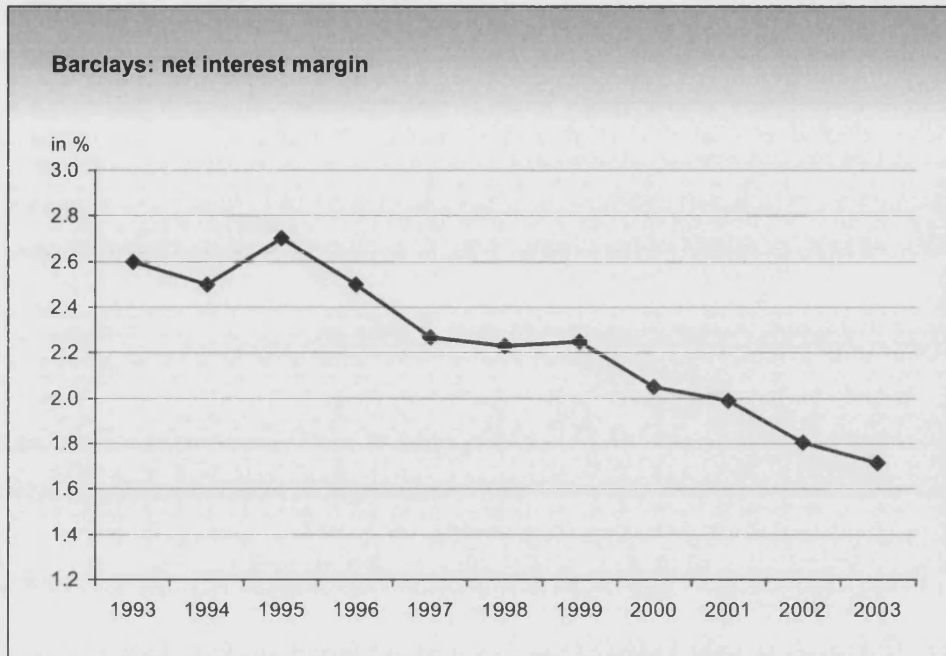
Despite Martin Taylor's rapid action to refocus Barclays' strategy and Matthew Barrett's expansion policy, the bank's income structure did not change significantly during the period analysed. Although Barclays exited investment banking in 1997, this decision is hardly reflected in its trading and commission income.

Barclays generated 52% of its total operating income from net interest income in 1993 and this proportion remained stable until 2003. The same trend is observed in the bank's commission income, which stayed more or less around 35% throughout the period under review. Barclays' trading income is the least stable figure, which however reflects the volatile nature of trading income.



While Barclays' proportion of net interest income was stable between 1993 and 2003, its net interest margin declined. The net interest margin fell from 2.60% in 1993 to 1.71% in 2003. The bank's low net interest margin resulted from a low interest rate environment in the UK and other western countries during that period and from disintermediation through various new savings products, such as investment funds for retail clients. Moreover, competition in

commercial lending intensified in the UK during the 1990s (interview Martin Taylor).



Management's focus on improving the quality of its loan portfolio, reducing costs and introducing better risk management tools is reflected in the flat revenue development between 1993 and 1998. Total operating revenues stayed around GBP 7.4 billion throughout that time. In contrast, total operating income rose to GBP 12.4 billion in 2003, up from GBP 7.4 billion in 1998. The compound annual growth rate for total operating income was 5.3% p.a. in 1993 to 2003. The following section will analyse the implications of the "cost and risk improvement phase" and "revenue growth phase" on Barclays' business segments.

5.6.2.2. Corporate and Investment Banking

In 1984 Barclays took steps to position itself for what was to become known as the 1986 Big Bang in Britain's banking industry by acquiring a broker and a jobber. It bought Zoete & Bevan⁷ (broker) and Wedd Durlacher Mordaunt (jobber) and merged them with its rudimentary merchant banking unit to form Barclays de Zoete Wedd (BZW) (Vander Weyer, 2000). In the following years, the different business cultures had to be integrated, while BZW continued expanding its business around the globe. With hindsight, Taylor described the response of Barclays' management to the challenges of Big Bang through the formation of BZW as a very courageous attempt, although it became his biggest problem as CEO of Barclays (interview Martin Taylor).

Effectively, BZW conducted Barclays' global investment banking operations and provided a broad range of transaction, advisory and risk management services. Since 1993, Barclays' large corporate banking business in the United States, including the bank's large corporate lending operations had been assigned to BZW (Barclays, Annual Report 1993, pp. 19-20). As of 1994 BZW also "assumed overall country responsibility for the management of large corporate lending in certain European and Asia-Pacific countries" (Barclays, Annual Report 1994, p. 11). In 1993, BZW still included the bank's asset management division, which became a separate business entity after the acquisition of Wells Fargo Nikko Investment Advisors in 1995.

1993 was the best year in the twelve-year history of BZW.⁸ The 1993 operating profit of GBP 501 million (Barclays, 1993, Annual Report, p. 34) meant a return on equity of over 40% (Vander Weyer, 2000, p. 215). However, the strong operating profit of 1993 was largely driven by a very fortunate trading result⁹ of GBP 625 million, which offset the losses from other divisions (Vander Weyer, 2000, p. 216). By 1993 BZW had developed a strong reputation as a lead underwriter for sterling bonds, an area of expertise on which Barclays Capital would be built after the disposal of its equities business in 1997 (Vander Weyer, 2000, p. 215).

⁷ The Bevans were one of the founding families of Barclays (Vander Weyer, 2000).

⁸ This was the same year as BZW launched the enhanced scrip dividend scheme. "A simple but radical solution to the problem of unrelieved Advance Corporation Tax for UK companies with substantial overseas earnings" (Barclays, Annual Report 1993, p. 19).

⁹ In 1993, 67% of Barclays' trading income came from interest and foreign exchange dealing and only 33% from equities (Barclays, Annual Report 1994, p. 23).

With some 6,000 employees (1993), half of whom were located in the UK, BZW considered itself a global investment bank. Yet Taylor conceded in the interview for this research that in fact the corporate finance division was of sub-scale and the equity business was only reasonably well positioned in Europe and in non-Japan Asia. It had a loss-making business in Japan and no significant business in the US. He then remarked, "You cannot be a global equities business and not be in the US. So we had no choice, we had to either buy an American broker or get out of it" (interview Martin Taylor).

By the end of 1996, BZW had staff of around 7,500, who contributed 17% of Barclays' total operating income and 9% of the group's GBP 2.3 billion operating profit. Taylor's intellectual interest in investment banking allowed him to quickly understand the volatile nature of this business and what that meant for capital allocation within the group. He also realised that the complexity of investment banking would continue to tie up management resources that were disproportional to the division's earnings contribution (interview Martin Taylor).

Following the sudden death of David Band, who was BZW's chief executive from 1988 until 1996, Martin Taylor decided to break up BZW and sell the equities business¹⁰ to CSFB, the investment banking arm of Credit Suisse. He was quoted as saying that the recent consolidation on the US investment banking market had contributed to his decision (Graham & Martinson, FT, 4 October 1997). More specifically, Taylor was concerned about the structural cost-income problem at BZW, which he believed could not be overcome (interview Martin Taylor). In October 1997, Barclays publicly announced¹¹ that it intended to withdraw from the equities, equity capital markets, and mergers and advisory businesses, together with all of the investment banking business in Australasia¹² (Corrigan & Lewis, FT, 3 October 1997; *Süddeutsche Zeitung*,

¹⁰ According to press articles at the time, CSFB paid GBP 100 million for the acquisition of BZW's equities business. By contrast, according to *The Economist*, Barclays actually paid at least GBP 688 million to exit investment banking. In his account, Martin Vander Weyer derives a total of GBP 724 million (*The Economist*, 7 February 1998; Vander Weyer, 2000, p. 244).

¹¹ Taylor was much criticised for publicly declaring that he wanted to dispose BZW ahead of the actual deal. CSFB, the eventual buyer, probably enjoyed greater bargaining power after Taylor's statements. However, Taylor's public announcement could also have been seen as an invitation to other potential bidders, thus intensifying the competition among interested buyers.

¹² The 1997 annual report revealed that the BZW businesses sold had been loss-making in the years 1995, 1996 and 1997. The breakdown of Barclays' segmental income statements into the "Former BZW Businesses" and "Barclays Capital" also shows that the largest proportion of trading income originated from bond and currency related products, which remained with "Barclays Capital" (Barclays, Annual Report 1997).

4 October 1997; Graham & Martinson, FT, 4 October 1997; Barclays, Annual Report 1997, p. 8).

After the sale of BZW's equities business - some operations were closed down, e.g. the equities business in Japan - Barclays found itself left with interest rate sensitive and credit sensitive businesses. These comprised the fixed-income, foreign exchange treasury, structured finance, trade financing, derivative, and commodity trading operations, which were renamed "Barclays Capital". Under the leadership of Robert Diamond, who joined Barclays from CSFB where he had been in charge of global fixed income and foreign exchange (Vander Weyer, 2000, p. 224), Barclays built an "integrated credit and capital markets operation to offer syndicated lending and bond underwriting" (Corrigan & Lewis, FT, 23 October 1997).

Robert Diamond was quoted as saying that the new focus on the integration of the credit side would be a bet on the emergence of a large and liquid credit market after the beginning of European Monetary Union – not least as the focus would shift to credit risks after the disappearance of currency risks. Barclays' management expected that this strategy would allow the bank to benefit from structural changes in the financial services industry. Barclays Capital's focus on the European debt market was the bank's response to the breaking up of traditional bank relationships, i.e. the trend towards disintermediation, which should spur the issuance of corporate bonds. Management anticipated a reduction in government bond issuance, but also foresaw the development of private pensions to drive the demand for corporate bonds (Corrigan & Lewis, FT, 23 October 1997; Shearlock, *The Banker*, 1 December 1997).

While BZW contributed 17% to Barclays' total operating income and only 9% to the group's operating profit in 1993, the division's best year, Barclays Capital generated 22% of total operating income and 22% of the group's total operating profit in 2003. Alongside this more balanced structure in 2003, Barclays Capital also achieved an operating profit of GBP 835 million (1993: GBP 532 million) with a lower headcount (5,800 vs. 6,000). At the end of 2003 Barclays Capital was number 4 in the global all debt league table, with a market share of 4.7% (i.e. USD 200 billion of debt issuance) and maintained

its lead position in Sterling bond issuance with a 19% market share (Barclays, 2004, Presentation 12 February 2004).

5.6.2.3. Asset Management

With the exception of the acquisition of Wells Fargo Nikko Investment Advisors (WFNIA) in 1995, Barclays grew its asset management operations organically during the period analysed. The bank's organic growth strategy concentrated on increasing assets under management. Although Barclays managed some GBP 30 billion worth of assets at the beginning of 1993, it gained substantial volume through the Wells Fargo Nikko Investment Advisors deal¹³ which brought in another GBP 110 billion¹⁴ (USD 170 billion) (Börsen-Zeitung, 20 September 1995).

It was only after the acquisition of the San Francisco-based WFNIA for GBP 280 million (USD 440 million) that Barclays' asset management operations became a separate business segment within the Barclays group (Gapper, FT, 24 January 1996; Barclays, Annual Report 1996). Before that Barclays' asset management operations were part of the bank's investment banking arm, BZW. The newly formed segment, Barclays Global Investors (BGI), was created through the merger of BZW Asset Management and WFNIA, fundamentally changing the structure of Barclays' asset management business.

While BZW's asset management unit was primarily an active asset management house (with around two third being actively managed mandates), WFNIA was particularly strong in passive and quantitative fund management (FT, 22 June 1995; Barclays, Annual Report 1996). Because of the WFNIA acquisition, Barclays Global Investors (BGI) became the largest passive fund manager in the world with GBP 170 billion of passive funds and GBP 36 billion of active funds (Barclays, Annual Report 1995). At the end of 2003, Barclays had GBP 598 billion assets under management, of which 69% were index-linked mandates (i.e. passive funds).

The rather technical and standardised approaches to passive (indexed) asset management generally keep profit margins thin in this particular area of asset management. As Barclays remained primarily focused on passive asset management¹⁵ after the acquisition of WFNIA, BGI's profit contribution was

¹³ The deal was closed on 31 December 1995.

¹⁴ At the time, WFNIA had some 800 employees.

¹⁵ Additional asset management services and products were also offered. For example, stock lending and the development of exchange traded funds.

moderate for most of the time. In 1994, Barclays' asset management business contributed only 2.3% to the bank's operating income and a meagre 1.5% to the operating profit. This compares to 5.4% of Barclays' operating income and 3.8% of the bank's operating profit in 2003 (Barclays, Annual Report 1994; Barclays, Annual Report 2003). The improved profitability was largely due to a gradual expansion into active asset management from 2002 (Gapper, FT, 16 October 1996; Barclays, Annual Report 1997; Willman, FT, 20 September 2000).

5.6.2.4. Retail Banking

Under Martin Taylor's leadership, Barclays' retail banking strategy concentrated on enhancing efficiency by reducing branch numbers and personnel and investing in information technology. In Barclays' 1993 annual report management emphasised the good progress in introducing complementary delivery channels in its UK retail banking (Barclays, Annual Report 1993), not least through the heavy investment in information technology - some GBP 800 million throughout the group in 1993 (a divisional breakdown was not disclosed).

In 1993, a separate brand, Premier Banking, was introduced to serve high-earning personal banking customers and the following year a telephone banking service, Barclaycall, was launched in the UK. As noted in the 1994 annual report, Barclays' retail banking arm in the UK underwent a "major investment programme to improve and expand the range of customer services and delivery channels, reduce costs and improve operating efficiencies and risk management" (Barclays, Annual Report 1994, p. 6).

In the same year, Barclays also set up the European Retail Banking Group (ERBG) to bring together its retail banking operations in six continental European countries and Merck Finck, its German private bank (Barclays, Annual Report 1994, p. 9). The 1995 annual report presented The European Retail Banking Group as a separate business unit that delivered a widening operating loss of GBP 31 million (GBP 8 million loss in 1994). The mounting losses in this segment were due to higher loan loss provisions and restructuring expenses at Barclays' German subsidiary, Merck Finck (Barclays, Annual Report 1995, p. 16; Börsen-Zeitung, 28 February 1996).

Shortly after the poor results of its European Retail Banking Group had been revealed, Barclays subsumed these operations into a newly formed division called International and Private Banking. In the following years, Merck Fink received several capital injections.¹⁶ Finally Barclays' management officially explained that Merck Fink no longer fitted into its strategy (Börsen-Zeitung, 26 March 1999) and sold the bank with its 414 employees to Belgium's KBL bank in 1999 for DM 500 million (Graham, FT, 17 June 1999). As previously stated, Taylor held the view that Barclays should not have bought Merck Fink in the

first place (interview Martin Taylor).

Under Taylor, Barclays' pan-European strategy gradually withered away as he did not really have one. He preferred to consider each of Barclays' European operations as a separate business. Most of them were wealth management businesses that did not compete with the local retail banks as their focus was on a small number of wealthy clients. Taylor took a particularly strong interest in the Spanish banking market which he considered the most professional one on the European continent at the time, as it had not been nationalised, and did not have "the dead weight of the subsidised competition" (interview Martin Taylor). Enthusiastically he remarked, "in Spain banking was fantastic and it was the first country to use computers in retail banking, and also the customers were very educated" (interview Martin Taylor).

Notwithstanding the absence of a coherent European strategy, Barclays and especially Taylor worked very hard at buying Credit Lyonnais in 1997. What stopped Barclays in the end was not Barclays' board of directors, which was interested in the acquisition, but the change of government in France. President Jacques Chirac called an election in 1997, as a result of which conservative Prime Minister Alain Juppé lost his job and socialist Lionel Jospin took over. This caused Barclays to lose interest (interview Martin Taylor).

Martin Taylor's successor, Matthew Barrett revived the bank's European vision. Barrett saw European expansion as essential, as continental economies would become more integrated and Barclays' internationally recognised brand should make it easy to enter foreign markets (Willman, FT, 20 September 2000). He said, "Barclays wants to become a pan-European bank," and added that Barclays wanted to increase the proportion of earnings from outside the UK from 20% in 2001 to 50% in the coming years. However, this target would not necessarily have to be achieved through acquisitions, but rather through organic growth of the Barclays Capital and Barclays Global Investors business units (Börsen-Zeitung, 9 February 2001).

Management deviated from its organic growth path when it launched a EUR 1.1 billion takeover bid for the Spanish bank Banco Zaragozano in May 2003. At the end of 2002, Banco Zaragozano had 570,000 clients that were served

¹⁶ A total of DM 400 million was estimated (Börsen-Zeitung, 26 March 1999).

through 526 branches. According to Barclays' management, the estimated cost synergies were just EUR 100 million, while revenue synergies were not quantified (Barclays Press Release, 8 May 2003).

With the arrival of Barrett, the bank's retail strategy gradually shifted from cost-cutting measures towards new ways of increasing revenues (Graham & Targett, FT, 16 February 2000). Despite this more expansive policy, Barclays' management deemed it had too many branches relative to its UK peers. Therefore, the board decided to close 171 of its 1,729 UK branches on a single day in April 2000. Unfortunately, 60 of these branches were the last remaining banks in their towns, which led to a public uproar.¹⁷ This led to a general debate about social exclusion¹⁸ if access to bank branches is impeded (Tighe, FT, 8 April 2000; Treanor, The Guardian, 8 April 2000; The Economist, 18 November 2000).

Barrett considered Barclays' growth potential to be particularly significant in the UK retail mortgage market, where he felt that the bank had fallen behind its competitors. In summer 2000, he announced that he would like Barclays to expand its mortgage operations. At the time Barclays had a market share of 1% of the British mortgage business (Börsen-Zeitung, 4 August 2000), which Barrett intended to double within three years (Graham & Targett, FT, 16 February 2000).

A month later Barclays made a GBP 5.6 billion friendly bid for Woolwich, the former building society.¹⁹ The initial estimates published in the offer document suggested the deal would yield GBP 150 million cost savings and GBP 90 million of increased revenues by 2003. As with most domestic mergers in the banking industry, the biggest savings were expected to come from job cuts in the bank's back office and from the closure of urban branches in the same neighbourhood.

Woolwich offered Barclays access to a large IFA (independent financial advisor) distribution network and added another 412 UK branches to Barclays'

¹⁷ The whole debate got particularly heated as Peter Middleton's (Barclays' chairman) salary package of GBP 1.4 million was revealed on the same day as the branch closures were announced (The Economist, 18 November 2000).

¹⁸ The discussion was fuelled by the Cruickshank report on bank profitability, which argued that insufficient access to bank accounts may be a source of social exclusion.

¹⁹ Woolwich was founded in 1847 and converted from mutual to plc status in 1997.

1,728 UK branches, around 100 of which were subsequently closed. The complementary multi-channel distribution networks of Barclays and Woolwich provided a compelling strategic rationale for the deal according to Barclays' management (Barclays, Presentation, 11 August 2000; Willman, FT, 6 September 2000). The acquisition of Woolwich increased Barclays' share of the UK mortgage market to 10% (Willman, FT, 20 September 2000). Furthermore, Woolwich successfully operated a state-of the-art technology platform to combine products for customers, which facilitated cross-selling.

The increased revenues were expected to come for instance from selling Woolwich customers Barclays' credit cards. The Barclaycard has arguably been Barclays' most successful product since its introduction in 1969. Barclaycard emerged as Britain's biggest credit card issuer with 9 million customers at the end of 2003. The Barclaycard segment contributed 13% (GBP 284 million) to Barclays' overall pre-tax profit in 1996²⁰ and increased to 19% (GBP 723 million) in 2003. Barclaycard also helped Barclays to tap the small and medium sized enterprise market by offering credit card solutions for corporate customers.

At the time of the Woolwich acquisition Barclays had 1.25 million online customers, making it Britain's largest internet bank (Willman, FT, 24 May 2000; Barclays, Presentation, 11 August 2000). In 2000, Barclays stepped up its investments in e-commerce to GBP 325 million, compared with GBP 180 million in the previous year. By the end of 2003, Barclays had in total 4.5 million online banking clients. Matthew Barrett refrained from building a stand-alone internet bank and preferred an online solution that was fully integrated into the organisational structure of the group (Graham & Targett, FT, 16 February 2000). Barrett wisely foresaw in 2000 that "five years from now there will be no e-business and no dotcoms. There will only be companies that have learned how to change their business models and survive and those that have fallen by the wayside" (Graham & Targett, FT, 16 February 2000). He added "this thing of running out and doing some kind of anorexic internet bank to impress the dotcom market is kind of fun, but it isn't good strategy" (Graham & Targett, FT, 16 February 2000).

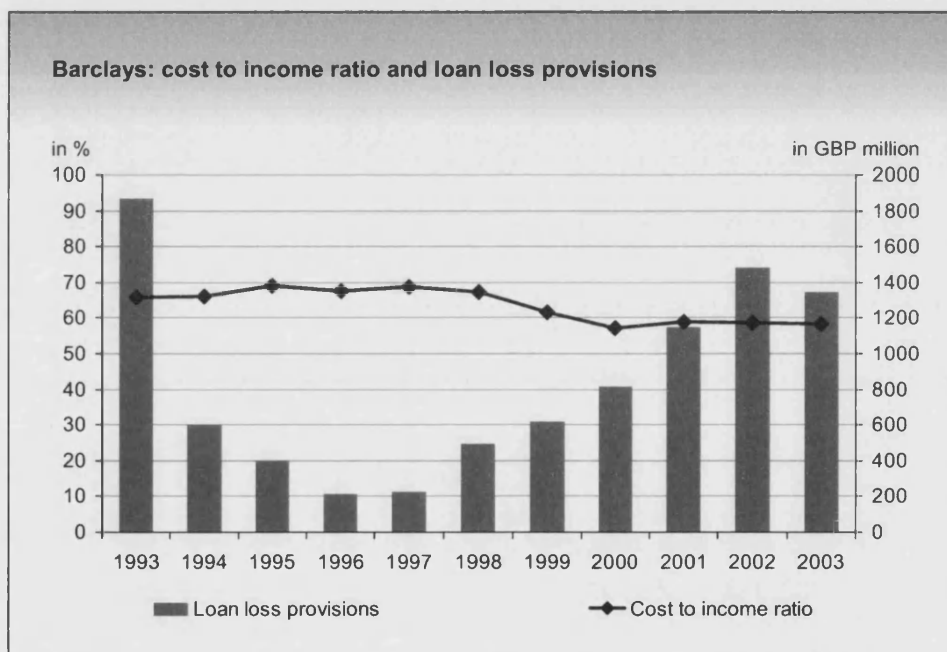
While Barclays dealt with the bank's weak position in the mortgage business

by acquiring Woolwich, it opted for a strategic alliance to strengthen its life insurance operations. Only few months after the Woolwich deal, Barclays announced that it had agreed with UK insurer Legal & General (L&G) to sell L&G's pension and investment products in return for a commission fee (Bolger, FT, 17 January 2001; *The Banker*, 1 February 2001). Barclays shut down its own life assurance operations and passed administration of unit trust sales over to L&G. The agreement was not exclusive and allowed L&G to broaden its access to the small business market, which was expected to gain significance following the introduction of the so-called stakeholder pensions, a low-cost, government-backed pension scheme, in April 2001 (Bolger, FT, 17 January 2001; *The Banker*, 1 February 2001).

²⁰ There are no figures for earlier years.

5.6.3. Cost and Risk Management

When British interest rates began to rise in the early 1990s, Barclays faced a backlash from its improvident lending policy during the 1980s. As already referred to in the introduction to this case study, the bank's desire to grow and keep its position as Britain's largest bank motivated a lending spree²¹ to UK homebuyers (Vander Weyer, 2000). As interest rates rose, the property values against which loans were secured declined (The Economist, 26 October 1996; The Economist, 18 November 2000). Consequently, Barclays' risk provisions soared to GBP 2.5 billion in 1992, eating up 37% of its total operating income for the year and 67% of net interest income.



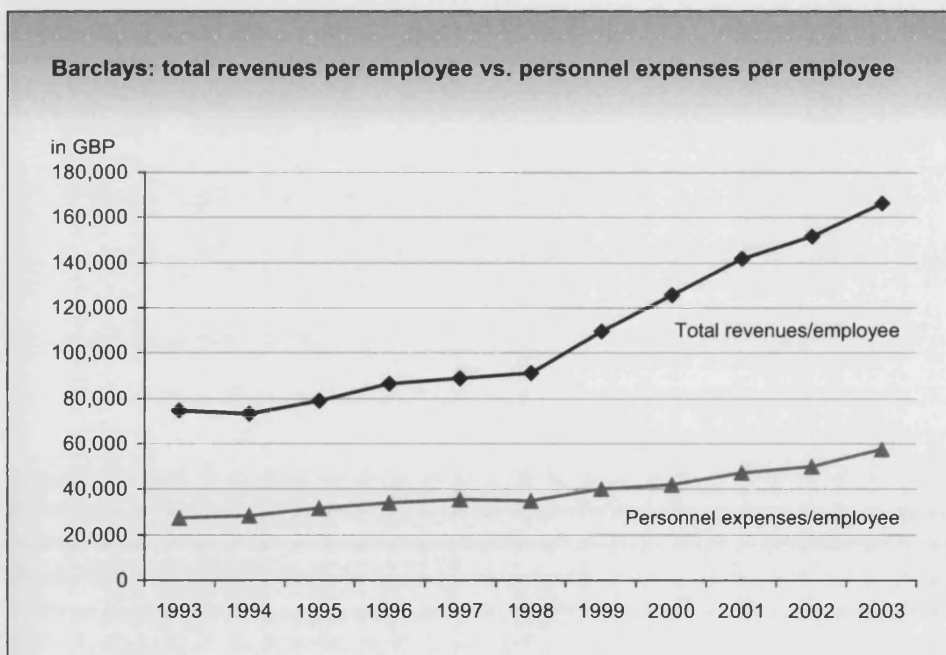
According to Martin Taylor, who took over as CEO in 1993, the provisions for impaired loans booked in 1992 were not enough. Therefore, he had to make loan loss provisions in 1994/95 that should have been taken in 1992 (interview Martin Taylor). When he arrived at the bank, he identified three fundamental problems with the loan portfolio. After nearly two years in office Taylor concluded that the bank had grown too fast, had wrongly priced its loans and

²¹ Barclays also lent to US companies on terms that did not adequately price in the underlying risk, hoping for more profitable business at a later stage, in particular for its investment banking arm BZW. It used to be common practice for large banks with "strong balance sheets" to "buy" investment banking deals in the 1990s (Waters, FT, 10 November 1994). At the start of 1993, Barclays did business with 900 US companies, but reduced the number to 200 within two years, in order to have fewer and deeper

had built up huge industry concentrations on its loan books, which posed a cluster risk (The Economist, 26 October 1996).

Subsequently, Barclays reviewed its lending policy, especially with the aid of new information technology. In 1994, it introduced the "Lending Adviser" programme that helped to assess individual loans and monitor its overall loan portfolio. The experience of rocketing loan loss provisions prompted management to abandon the bank's growth paradigm and shift towards a risk-adequate pricing policy (The Economist, 26 October 1996).

Moreover, Taylor addressed the efficiency of retail banking and cut the number of branches drastically, while investing heavily in new technologies for new distribution channels. Introducing new technologies along with further measures to improve efficiency cut the bank's headcount by 18,500 between 1991 and 1996, reducing total staff numbers to 66,000. Barclays' focus on domestic retail banking and its relatively moderate investment banking exposure is reflected in a moderate rise in personnel expenses per employee.

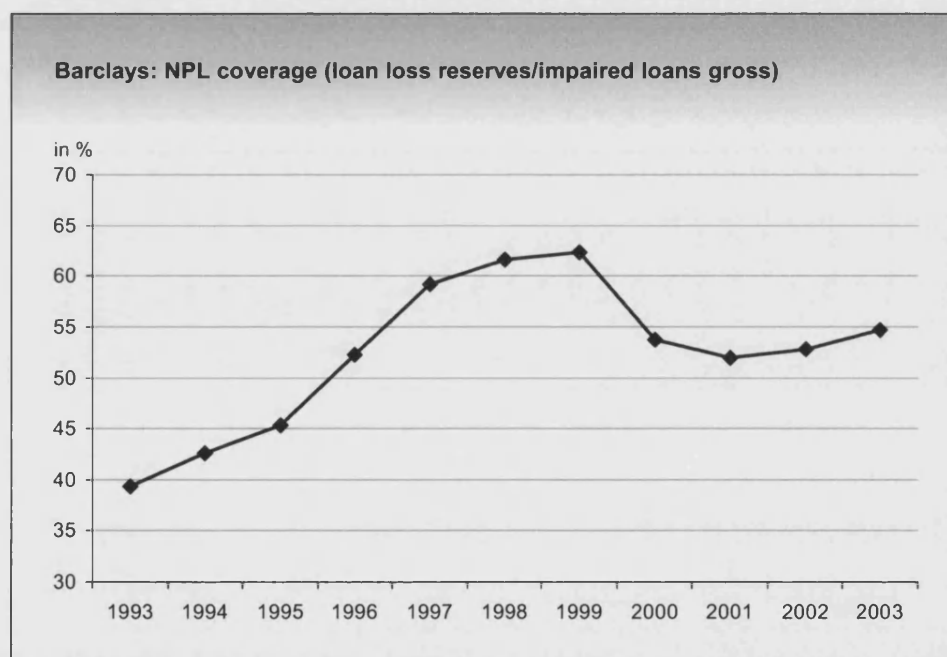


While the proportion of personnel expenses relative to the bank's total operating expenses before risk provisions remained stable at 58% on

relationships according to Martin Taylor (Waters, FT, 10 November 1994).

average, it rose by a compound annual growth rate of 7.6% p.a. during the period analysed. The absolute number of employees declined from 99,000 in 1993 to 74,800 in 2003.²² As fewer employees continuously generated more income during the period under review, the group's cost income ratio improved from 66% in 1993 to 58% in 2003. This positive development mirrors the efficient use of new technologies and economies of scale.

The development of the UK economy and Barclays' continuous focus on UK retail banking did not lead to a decline in the bank's overall loan portfolio between 1993 and 1999. However, the quality of the loan portfolio improved noticeably during that period, as illustrated by the rise of Barclays' coverage ratio (loan loss reserves relative to problem loans). The accelerated improvement of asset quality was facilitated by using a "workout bank".²³ A separate segment called "Business in transition"²⁴ was set up to deal with assets that needed "restructuring" and that would be ultimately disposed of as they did not constitute core activities of the bank.



²² At the end of 1990, the number of employees was still 116,800 (Barclays, Annual Report 1990, p. 26).

²³ The "United States Transition" division was established in 1993 to scale back credit exposure in the US. As of 1995 it was renamed "Businesses in Transition" and also comprised various loans and other assets that were not considered to be of long-term interest to the group or which required significant restructuring (Barclays, Annual Report 1995, p. 10). "Business in Transition" was dissolved in 1999.

²⁴ Nearly a decade later, Dresdner Bank, shortly after its takeover by the insurer Allianz, set up an Institutional Restructuring Unit (IRU, also referred to as "loan hospital"), to accelerate the reduction of problem loans.

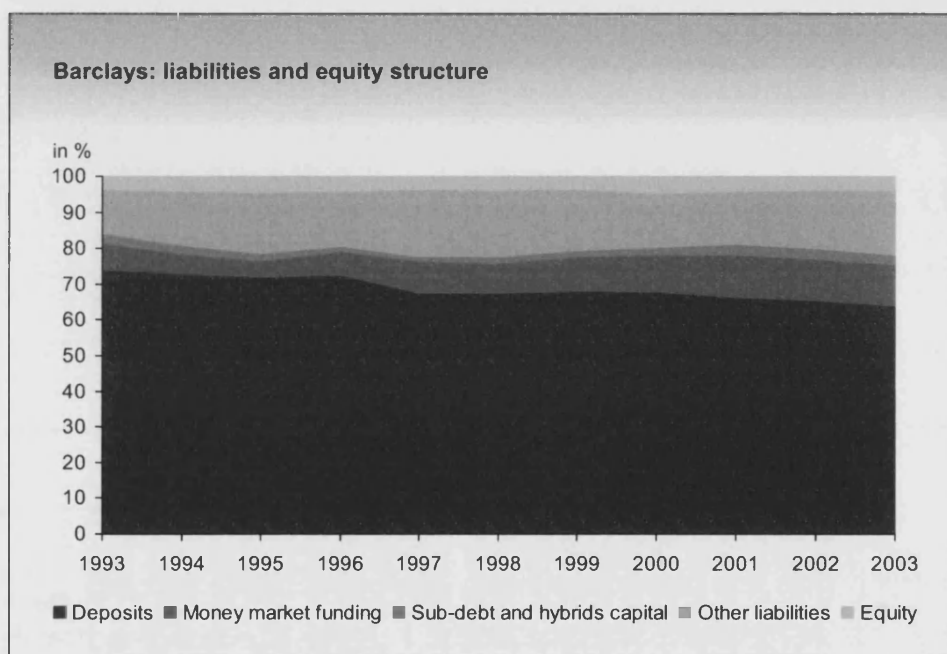
More risk-adequate pricing of loans also reduced the proportion of annual loan loss provisions relative to total outstanding loans. However, this ratio deteriorated again in the aftermath of the 1998 financial markets crises in Asia and Russia.²⁵ The subsequent attempts to bail out the highly leveraged hedge fund Long Term Capital Management (LTCM) required Barclays to contribute USD 300 million (The Economist, 18 November 2000). These turbulent financial market conditions certainly accelerated Taylor's departure, despite his successful efforts to improve the bank's risk and cost management.

During the years under Taylor's leadership, Barclays' loan portfolio fluctuated between GBP 90 and 100 billion, but subsequently more than doubled in the years up to 2003. His time as Barclays' CEO was dominated by stringent cost and risk control, whereas Barrett's era was characterised by rising revenues and a new growth paradigm. Yet, in 2000 Barclays' management proclaimed that the group's sustainable annual cost base would be reduced by GBP 1 billion over the four years from 2000 to 2003 (Graham & Targett, FT, 16 February 2000; Barclays, Annual Report 2003). Although the cost income ratio did not improve between 2000 and 2003, management still explained in its 2003 Annual Report that the cumulative total cost savings of GBP 1.26 billion exceeded the four-year goal by 26% (Barclays, Annual Report 2003).

²⁵ Barclays lost some GBP 250 million on Russian government bonds (The Banker, 1 January 1999; The Economist, 18 November 2000).

5.6.4. Asset-Liability Structure

The more restrictive lending policy during the period when Taylor was Barclays' chief executive officer would have led to a strong rise of the bank's tier 1 ratio if the bank had not launched a share buyback programme in August 1995. Between 1995 and 1999 Barclays bought 207 million of its own shares for GBP 2.3 billion.²⁶ Further share buyback programmes followed in each year until 2003. In total Barclays spent an additional GBP 1.1 billion to buy its own shares, thereby keeping the equity level low and the tier 1 ratio between 7% and 8% for most of the time.²⁷

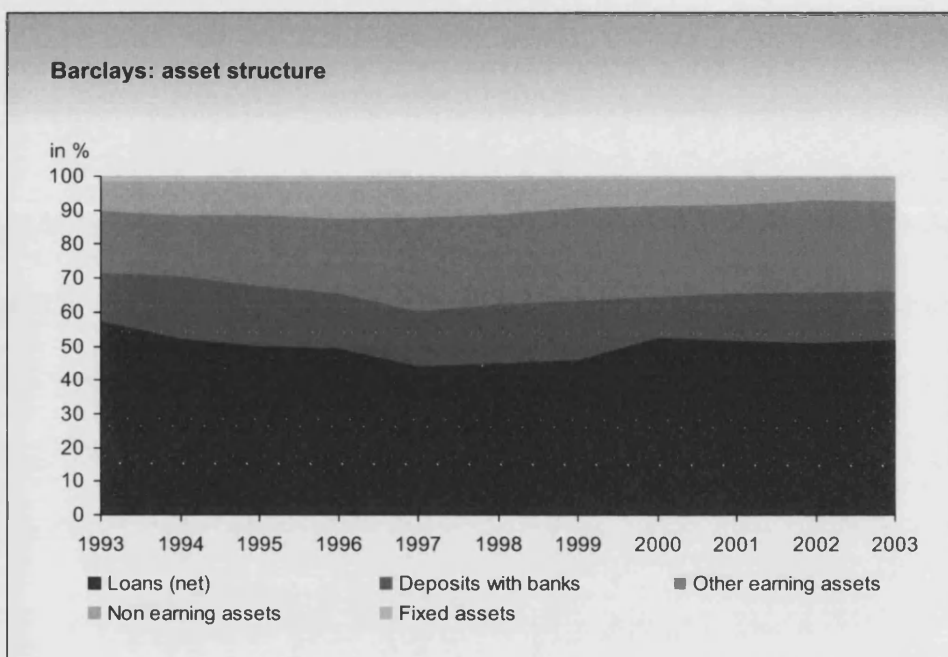


During the period analysed, Barclays' equity ratio was 4% on average, fluctuating in a narrow band between 3.5% (1997) and 4.8% (2000). In contrast to that stable picture, the proportion of deposits (from customers and banks) relative to total liabilities declined from 1993 until the end of 2003. This decline can be partly explained by Barclays' shift to funding through money market instruments in response to the growing importance of disintermediation.

²⁶ Barclays Investor Relations homepage [online] Available from: <http://www.investorrelations.barclays.co.uk> [Accessed 23 January 2005].

²⁷ The two exceptional years were 1993 (5.9%) and 2002 (8.2%).

Disintermediation also seemed to be the driving force behind the decline in net loans relative to deposits from 1993 until 1999. In 1993, 77.5% of deposits were still tied up in loans, whereas by the end of 1999 the ratio was down to 67.4%. However, in 2000, the "loans-deposits ratio" rose sharply again to 77.4% as a reaction to the acquisition of Woolwich. In the following three years, this ratio increased further to 81.3%, demonstrating Barclays' continuous focus on retail banking. The high "loans-deposits ratio" indicates the overall prominent role of Barclays' retail banking activities.



Net loans to customers as a proportion of total assets were relatively stable during the period analysed. They declined by just 5 percentage points from 57% in 1993 to 52% in 2003. The average was 50% in this period. Deposits with banks, which may also be regarded as loans to other banks, tied up on average 16% of Barclays' assets. Notwithstanding the 9.3% compound annual growth in its loan portfolio between 1993 and 2003, Barclays' asset structure did not change substantially during the decade.

5.6.5. Profitability

In 1992, the first ever loss in Barclays' history (net loss of GBP 343 million) prompted management to review the growth maxim of the preceding years. Andrew Buxton, Barclays' chairman between 1993 and 1999, set an after-tax return on equity target of 15% for the group and acknowledged that the bank could afford to lose market share in return for improved profitability (Gapper, FT, 6 August 1993).

After a still weak return on equity of 6.4% in 1993, a reduction of nearly GBP 250 million in operating expenses and a significant reduction in loan loss provisions boosted the group's ROE to 20% in 1994. Relatively tight cost control, along with the efficiency gains from new technologies in retail banking and a benign lending environment led to ROEs that were consistently above 15% in the years up to 2003.

With the arrival of Taylor in autumn 1993, Barclays embarked on a course that would trim costs, improve risk management and cut the range of business activities. Taylor's previous experience in the textile industry helped him to recognize the "industrialisation" of banking in general and of retail banking in particular (interview Martin Taylor). The use of complementary delivery channels, which became possible through new information technology in the 1990s and the implicit unbundling of retail banking contributed to significant efficiency improvements.

Setting a return on equity target for the whole bank ultimately has implications for each segment. First, internal rivalry about capital allocation arises. Second, a comparison of segmental ROEs may create tension among the different business segments, if the profitability deviates significantly, regardless of the actual level of profitability. This relative profitability was also the underlying cause for the disposal of Barclays' investment banking arm, BZW, in 1997 (interview Martin Taylor).

BZW's returns on equity increasingly diluted the group's overall profitability. In 1996 BZW made an operating profit of GBP 204 million, producing a return on capital of 8% compared to some 34% for personal banking (Graham & Martinson, FT, 4 October 1997). The improved returns reported by Barclays'

UK banking services, along with the rising demand for risk capital at BZW, represented conflicting developments. Moreover, the different corporate cultures of a UK clearing bank and an international investment bank became insurmountable (interview Martin Taylor).



In the light of these different performances and internal competition for risk capital, Barrett introduced the concept of value-based management (VBM). The value-based management approach focuses on economic profit. Barclays' definition of economic profit is the "profit after tax and minority interests, excluding goodwill amortisation, less a charge for the cost of average shareholders' funds (which includes purchased goodwill)" (Barclays, Annual Report 2001, p. 15).

In 2000, Barrett announced that he wanted the bank to double economic profit in four years (Graham & Targett, FT, 16 February 2000; Barclays, Annual Report 2003). The cumulative economic profit over the period 2000 to 2003 would have been GBP 6.1 billion. According to management's own calculations, which are difficult to check, the cumulative economic profit for this period totalled GBP 5.3 billion. Although Barclays' management missed its, maybe overly ambitious, profitability target, the bank still delivered an

average return on equity of 18% for that period, and therefore exceeded the old 15% ROE target set by Andrew Buxton in 1993.

5.6.6. Conclusion

Barclays underwent two phases during the decade under review, each distinctly shaped by its CEO at the time. During the years under Martin Taylor's leadership, Barclays was dominated by stringent cost and risk control, whereas Matthew Barrett's era was characterised by rising revenues and a new growth paradigm. Barrett was only able to concentrate on revenue growth again because of Taylor's legacy. Without Taylor's managerial rigour in addressing cost, risk and cultural issues at Barclays, Barrett would not have been in such a comfortable position to induce a new momentum.

Taylor remarked that upon his arrival the prevailing characteristic of this old-style traditional British bank was its arrogance and lack of realism, which he found everywhere within Barclays, most strikingly among the bank's top management (interview Martin Taylor). According to Taylor, there existed a strong cultural affinity to some of the weakest businesses in the bank, combined with a weak affinity to some of the best businesses in the bank. He found that this corporate culture was also reflected in the bank's risk and capital management (interview Martin Taylor).

Besides putting decent risk and credit management tools in place, Barclays under Taylor rethought its financial strategy and particularly its capital structure. It was the first major European bank to buy back its own equity, based on the view that the ROE could be raised through less equity, rather than trying to push for returns (interview Martin Taylor). This financial strategy laid the foundation for Barrett's concept of value-based management (VBM) and the respectable return on equity that averaged 17.6% (net) in 1993 to 2003.

In many ways Taylor, with his non-banking background, was the right person for the position as Barclays' CEO after the bank's first ever loss in 1992. His unbiased approach and sharp intellect allowed him to analyse the situation at Barclays thoroughly. He arrived in time to ring the alarm bell at this incrustated institution and addressed issues that appeared sacrosanct, such as the disposal of BZW and the closure of branches. Taylor was an apt choice for a job that required understanding archaic traditional structures, paired with the challenges of fast-changing financial markets. Overall, he introduced the right,

and in any case necessary measures, for Barclays to be turned around.

Although an analytic mind like his is well suited for disentangling a complex situation and putting forward sensible solutions, this type of intellectual approach weighs heavy when it comes to the mundane task of pushing sales, developing new products and being alert towards the needs and interests of clients. For example, unlike most of his colleagues at Barclays, Taylor took an intellectual and political view on European financial integration. More specifically, this caused him to worry about the absence of a proper EU services directive and to call off the acquisition of *Crédit Lyonnais* because of a change of government in France (interview Martin Taylor).

By contrast, the more hands-on Barrett bought the Spanish bank *Banco Zaragozano*, without much ado, thereby strengthening Barclays' position on the Iberian Peninsula. A gifted salesman, he stepped in just at the right time to introduce a client and sales-oriented corporate culture that would boost revenues. During his time as CEO, he could take advantage of a reduced cost base, a more nimble organisation, improved risk management and a flourishing British economy. After the cost cutting and trimming phase under Taylor, Barrett revived growth and took a more entrepreneurial approach, for example, through the acquisition of *Woolwich*.

During the period analysed, Barclays broadened its product range in retail banking, but remained focused on few countries. The bank's corporate banking moved in the other direction, as it internationalised while confining its activities to debt capital market services. These changes were reasonably managed by two dissimilar CEOs, whose arrivals were well timed, notwithstanding Taylor's premature resignation. The complementary nature of Martin Taylor and Matthew Barrett persuasively illustrates that different times need different types of CEOs.

5.7. HVB Group AG / Bayerische Vereinsbank AG

5.7.1. Introduction and Status Quo in 1993

When the Italian banking group Unicredit acquired Bayerische Hypo- und Vereinsbank AG (also referred to as "HVB" or "Hypovereinsbank") for EUR 16 billion in June 2005, this was Europe's largest cross-border takeover in the banking industry (Jenkins, et al., FT, 14 June 2005). The deal came seven years after the two Munich-based banks Bayerische Vereinsbank ("Vereinsbank") and Bayerische Hypotheken- und Wechsel-Bank ("Hypo-Bank" or just "Hypo") announced their decision to join forces through a "merger of equals" to create what they called a "bank of the regions".

According to Hilmar Kopper, CEO of Deutsche Bank at the time, the deal was provoked by Deutsche Bank's disclosure in July 1996 that it had acquired a 5.2% stake in Vereinsbank. Vereinsbank's management and Bavarian politicians became concerned that Deutsche Bank could pursue a complete takeover of Vereinsbank and therefore called for a "Bavarian solution" (Koehn, Börsen-Zeitung, 28 August 1998; interview Hilmar Kopper; interviewee II).¹ There was considerable concern in Bavaria that a takeover by Deutsche Bank could subsequently trigger a bid for Hypo-Bank by Frankfurt-based Dresdner Bank, depriving Bavaria of its significance as a financial centre (Koehn, Börsen-Zeitung, 28 August 1998). Kopper made it clear in an interview with the author of this thesis that he indeed approached Albrecht Schmidt, Vereinsbank's CEO, and offered talks but realised after the phone call that his ideas were not welcome. Shortly afterwards Deutsche Bank sold its stake, which it had raised to just below 10%, realising a book gain of some DM 1 billion (interview Hilmar Kopper).

Regardless of Kopper's real intentions, the announcement certainly set off intensified talks between the two Bavarian banks. Moreover, there is little doubt that the merger between Vereinsbank and Hypo-Bank was welcomed

¹ For the HVB case study, the researcher did two structured and formal interviews. Both interviewees asked to remain anonymous. One interviewee is a well-informed, Munich-based financial journalist working for a leading German newspaper. This interviewee is referred to as "interviewee I". The other interviewee joined Vereinsbank in the early 1980s and rose to the rank of a member of HVB's executive management team (Bereichsvorstand). This interviewee is referred to as "interviewee II". Both interviews were carried out on 6 December 2006. In addition, several informal conversations with leading German bankers contributed to this case study.

by the Bavarian State (Associated Press, 21 July 1997; Börsen-Zeitung, 23 April 2004). Although it appears unlikely that politicians played an active role, the prime minister of Bavaria (Edmund Stoiber) obliged the banks with a one-off tax waiver on the implicit capital gains from the exchange of shares in the merger transaction (Koehn, Börsen-Zeitung, 28 August 1998; The Economist, 5 August 2000).²

Despite the deal being described as a “merger of equals”, there is sufficient evidence that Vereinsbank effectively took over Hypo-Bank³ (Sen, Metzler Sector Insight, 3 November 1998; The Economist, 5 August 2000). While this argument will be considered throughout the case study, at this stage of the analysis it is only of relevance in that it helps to clarify which bank this research should concentrate on in the period before the merger. Since Vereinsbank was the dominant force and provided the merged group’s CEO, Albrecht Schmidt, as well as the majority of the management board members, Vereinsbank should be at the heart of this study for the period between 1993 and 1997.

Bayerische Vereinsbank was founded as a mortgage bank by several private investors and members of the Bavarian nobility in 1869.⁴ When the large Berlin banks expanded their branch network into Bavaria at the turn of the century, Vereinsbank reacted by increasing the number of branches – not least so it could use deposits as a means of financing loans. 34 years before Vereinsbank was established, the business-minded Bavarian King Ludwig I initiated the formation of Bayerische Hypotheken- und Wechsel-Bank to provide mortgages (1835). The banks’ proximity and focus on mortgage banking had led to the idea of a merger back in the 1930s – a plan favoured

² As Vereinsbank owned 10% of Allianz, it offered Hypo-Bank shareholders six Hypo-Bank shares in exchange for one Allianz share. This enabled Vereinsbank to reduce its Allianz stake by around 8 percentage points without paying capital gains tax and to finance the deal without significantly diluting the share base (Koehn, Börsen-Zeitung, 28 August 1998). In order to bolster its capital base, the new group raised its capital by DM 3.6 billion through a capital increase (Koehn, Börsen-Zeitung, 28 August 1998). Besides, the State of Bavaria owned 25% of Vereinsbank. Allianz held a 25% stake in Hypo-Bank.

³ Throughout the case study, the term “merger” will be used.

⁴ In addition three large banks were integrated into the two institutions that later formed HVB. These were Bayerische Notenbank, Bayerische Disconto- und Wechsel-Bank and Bayerische Staatsbank. Bayerische Notenbank founded in 1875, merged into Bayerische Staatsbank in 1935. Bayerische Disconto- und Wechsel-Bank was set up in 1905 and taken over by Bayerische Hypotheken- und Wechsel-Bank in 1923 (officially dissolved in 1936). In 1971 Vereinsbank merged with Bayerische Staatsbank, the oldest bank in what later became the HVB Group. Bayerische Staatsbank was founded in 1780 in order to facilitate the leasing of Bavarian soldiers to the English throne. These soldiers fought the French in the new American colonies (HVB (undated). Hypovereinsbank Geschichte [online]: Available from: <http://geschichte.hypovereinsbank.de/> [Accessed 20 December 2006]).

by the Nazis but which did not materialise due to the outbreak of the Second World War (HVB, undated).

Throughout the 1970s and 1980s, Vereinsbank built up an international network, with offices and subsidiaries around the world (The Wall Street Journal Europe, 14 November 1995; interviewee II). Vereinsbank continued its internationalisation policy during the 1990s⁵. By contrast, Hypo-Bank had a more regional focus. Nevertheless, it also moved beyond the Bavarian border at the beginning of the 1970s, for example, as a founding member of Associated Banks of Europe Corporation (ABECOR). Moreover, in the early 1990s it expanded into Eastern Europe and therefore paved the way for HVB's Central and Eastern European strategy.⁶

Like the other three large German private banks (Deutsche Bank, Dresdner Bank, Commerzbank), Vereinsbank and Hypo-Bank moved into East Germany shortly after the fall of the Berlin Wall (FT, 29 June 1990; The Economist, 5 August 2000). Vereinsbank's CEO Albrecht Schmidt, who was born in East Germany and lived in Leipzig until he was 16, said in 1995: "For us East Germany was an important challenge and an unbelievable opportunity [...]. We had the chance to prove we could grow beyond being a regional bank. Our expansion into East Germany speeded up the process of us becoming a national big bank" (Fisher, FT, 19 July 1995).

Both Bavarian mortgage banks pursued relatively aggressive lending policies and rapidly grew their loan books through mortgage financing in the new German states. This "early-mover strategy" backfired some years later when it became obvious that many loans could not be repaid. The assumptions on which these loans had been based included an over-optimistic macroeconomic outlook (interviewee I). For example, the substantial loan loss provision of EUR 1.8 billion that HVB had to book shortly after the merger predominantly originated from its East German mortgage portfolio. Albrecht Schmidt blamed this "unexpected" write-down on the management of Hypo-

⁵ Initially Vereinsbank concentrated its European expansion policy on Mediterranean countries. For example, in 1989, it opened a branch in Greece and in 1990, Bayerische Vereinsbank announced a cooperation agreement with Spain's Banco de Sabadell. The cooperation should focus on commercial lending, stock-broking and corporate finance, but not much was heard about this cooperation thereafter (FT, 10 September 1990; interviewee II).

⁶ Bayerische Hypotheken- und Wechsel-Bank opened a subsidiary in Prague in 1992 (Süddeutsche Zeitung, 20 February 1995). Subsequently, subsidiaries in Budapest (1993), Warsaw (1995), and Bratislava (1997) were established.

Bank. This write-down helped Schmidt, who was CEO of Vereinsbank from 1990 until its merger with Hypo-Bank, to get rid of his rival Eberhard Martini, CEO of Hypo-Bank. Martini was CEO of Hypo-Bank from 1988 until the merger with Vereinsbank, when Albrecht Schmidt ousted him (The Economist, 5 August 2000).⁷

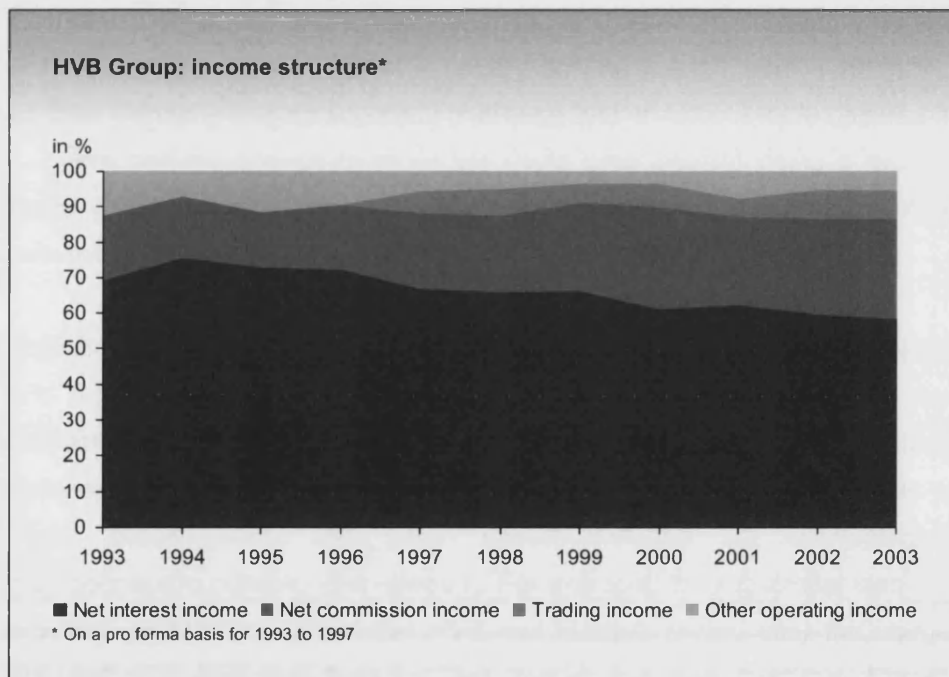
When the deal was sealed, the supervisory board appointed Schmidt as CEO of the new bank. He remained in this position until the end of 2002, when he was succeeded by Dieter Rampl, who was the bank's CEO until the end of 2005. Clearly, the most dominant figure throughout the period analysed was Albrecht Schmidt. He contributed substantially to the rise (at times HVB was Europe's largest lender) and fall of the bank. The rise and fall of HVB culminated in the takeover by Unicredit in 2005. The following case study will investigate the developments of HVB and its predecessor institutions from 1993 until the end of 2003.

⁷ The chairman of the supervisory board at Hypo-Bank between 1980 and 1997 was Klaus Götte. He also chaired the supervisory board of the merged bank until April 1999, when Kurt F. Viermetz replaced him. Viermetz held this position until the end of 2002 and was subsequently the bank's Vice-Chairman until the end of 2003. Chairman of the supervisory board of Vereinsbank between 1990 and 1998 was the bank's former CEO Maximilian Hackl, predecessor of Albrecht Schmidt.

5.7.2. Income Structure

5.7.2.1. Structural Overview

The dominant role⁸ of Vereinsbank during the integration process was certainly also supported by the fact that at the time of the alleged “merger of equals”, the institution headed by Albrecht Schmidt was bigger in terms of revenues (+15%), assets (+22%) and number of employees (+11%) (Sen, Metzler Sector Insight, 3 November 1998). Vereinsbank's EUR 3.9 billion total operating income in 1997 was generated with EUR 223 billion assets. This compares to EUR 183 billion assets at Hypo-Bank, which earned EUR 3.4 billion operating income in the same year. Total operating income of the merged HVB grew by a compound annual growth rate of 5.8% p.a. from the beginning of 1998 until the end of 2003. On a pro forma⁹ basis, HVB grew its total operating income from EUR 5.6 billion in 1993 to EUR 9.9 billion in 2003 – giving an average annual growth rate of 6%.¹⁰

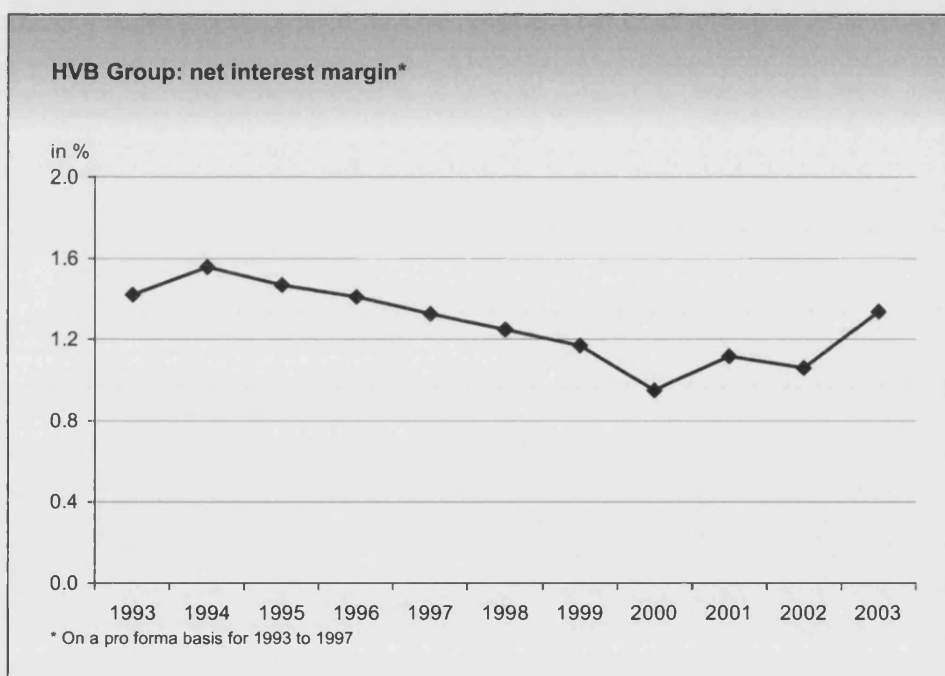


⁸ Only five out of fourteen executive board members at the newly created HVB were from Hypo-Bank (Sen, Metzler Sector Insight, 3 November 1998).

⁹ Bankscope “merged” Vereinsbank's and Hypo-Bank's balance sheets and income statements for the years 1993-1997. This pro-forma data allowed an analysis of HVB for the complete period of 1993 until the end of 2003.

¹⁰ In 1993, total operating income was 16% higher at Vereinsbank than at Hypo-Bank.

Although Vereinsbank was larger than Hypo-Bank, the sources of income and income structure of both banks were alike. In fact, both institutions' income structure followed a similar trend, namely a relative decline in net interest income. This trend persisted after the merger and reflected the banks' strong footing in low-margin mortgage banking. In 1993, Vereinsbank generated 68% of its total operating income through its net interest margin. In the case of Hypo-Bank, this was even 71%. The merged banking group earned 66% of its total operating income from net interest income in 1998. During the following years, the proportion of net interest income continued to fall and contributed just 59% in 2003. While net interest income lost significance during the period analysed, commission income and trading income gained prominence.



Prior to 1997 only Vereinsbank disclosed its trading income as part of its total operating income. As there is little information about the role of trading at Hypo-Bank (it was subsumed under "other operating income"), an analysis of the group's pro forma figures (1993-1997) is not possible. However, trading at Vereinsbank was comparatively low and contributed on average 3.7% of operating income in 1993-1997. On average 6.7% of HVB's total operating income originated from trading between 1997 and 2003. As the trading figures for 1997 are available for Vereinsbank (5% of operating income) and HVB (6.4% of operating income) it is possible to deduce that 7.7% of operating

income, i.e. EUR 262 million, originated from Hypo-Bank's trading desk in 1997. Between 1997 and 2003, trading gained further significance as it grew by a CAGR of 10.2% p.a. compared to HVB's total operating income which rose by just CAGR of 5.8% p.a. during the same period. Therefore, 8.3% of HVB's operating income came from trading in 2003. A relatively high figure for a bank that was not renowned for its investment banking expertise.

Despite Hypo-Bank's presumably higher earnings contribution from trading activities before 1997, the two banks' income structures were quite similar. Similarity also showed the low net interest margins of Vereinsbank and Hypo-Bank. HVB's net interest margin fell from 1.42% in 1993 to 1.34% in 2003 and bottomed out at 0.95% in 2000. The pro forma average net interest margin for the period 1993 to 2003 was 1.28%. The net interest margins of the two banks prior to the merger were very close and averaged 1.47% in the case of Hypo-Bank and 1.46% in the case of Vereinsbank. Possibly the best explanation of the low net interest margins is their focus on low-margin mortgage lending in the same region (Bavaria) during a phase of falling interest rates. The similarity of the banks' income structures and their identical geographic focus are likely to have almost certainly fostered unwanted cluster risks.

At the time of the merger, HVB's strategy was already geared to expanding its international reach, albeit only in Europe. In his first letter to the combined group's shareholders in 1998, Albrecht Schmidt said: "Our target market is Europe." He added that HVB was the first "bank of the regions in Europe" and that management planned to expand in Europe (HVB, Annual Report 1998). Geographical diversification gained significance following the EUR 7.1, billion takeover¹¹ of Bank Austria in 2000 (Kroneck, Börsen-Zeitung, 2003; Major & Hall, FT, 27 September 2000).¹² This allowed HVB to move into Eastern Europe and gain a foothold in Poland, the largest economy in the region.

As with all other banks analysed in this thesis, HVB's reporting segments varied during the period analysed.¹³ Therefore, a consistent segmental analysis is not feasible, corroborating the view that this research needs to combine quantitative and qualitative methods. In 2003, HVB reported a

¹¹ The takeover was in the form of a share-swap.

¹² Prior to the deal, more than 80% of earnings came from Germany (Major & Hall, FT, 27 September 2000).

¹³ The first time the bank disclosed its segments was in its 1998 annual report when it changed to the IAS accounting standards.

Germany segment, which comprised three sub-segments: Private Customers, Corporate Customer & Professionals and Commercial Real Estate Finance. Another major segment was Austria/CEE and consisted of: Private Customers Austria, Corporate Customers Austria, and Central and Eastern Europe. The third reporting segment in 2003 was Corporates & Markets. This case study follows the same structure as the others. Therefore, the next section will first discuss Corporate and Investment Banking, then HVB's Asset Management activities and finally Retail Banking.

5.7.2.2. Corporate and Investment Banking

For HVB and its two predecessors, real estate financing played an important role throughout the period analysed. In 1993, 45% of HVB's total loan portfolio was classified as mortgages (on a pro forma basis). This (figure) rose to 53% at the time of the merger¹⁴ (1997). Following the merger, the new bank's management continued to regard real estate financing as one of its core competences (Börsen-Zeitung, 22 July 1997). HVB was the largest real estate bank not only in Germany, but in the whole of Europe (Börsen-Zeitung, 22 July 1997). As a substantial proportion¹⁵ of HVB's mortgage portfolio came from commercial property lending, the bank's real estate business will be discussed as part of this section on "Corporate & Investment Banking" (Dries, Börsen-Zeitung, 3 May 1995).

The scale of HVB's real estate exposure to the corporate sector became obvious when management decided to spin off Hypo Real Estate as part of its restructuring plan in 2003. Each shareholder received one share in Hypo Real Estate for every four HVB shares. The bank therefore spun-off a fifth of its business. Due to the spin-off of Hypo Real Estate, HVB's loan portfolio declined by EUR 112 billion, i.e. 23%. The reduced lending volume was mirrored by a EUR 139 billion reduction in its liabilities, i.e. they declined by 24% (HVB, Annual Report 2003, p. 5).

While management consistently considered real estate financing a core competence of HVB and its predecessor banks, two distinct phases can be identified in its investment banking activities. During the first phase,¹⁶ Vereinsbank's management endeavoured to build up an international investment banking presence. In 1995, when Vereinsbank tried to acquire Oppenheimer & Co., a mid-size US brokerage firm with a strong asset management arm, Vereinsbank's CFO, Dieter Rampl, said he wanted Oppenheimer for the same reason rival Deutsche Bank bought Morgan Grenfell and Dresdner Bank bought Kleinwort Benson (The Wall Street Journal Europe, 14 November 1995). The rationale for the bank's decision to expand into transaction-oriented services was management's belief that

¹⁴ The merger was announced on 21 July 1997 and became effective on 1 September 1998.

¹⁵ For example, in 1994 commercial property lending at Vereinsbank made up 41% of the bank's mortgage portfolio and 13% of its total loan book (Dries, Börsen-Zeitung, 3 May 1995).

¹⁶ The first phase began in the early 1990s and lasted until around 1997/1998 (HVB, Annual Report 1998).

German corporate clients would increasingly request investment-banking services (The Wall Street Journal Europe, 14 November 1995).

Although management claimed it did not intend to compete against “bulge-bracket” US investment banks (The Wall Street Journal Europe, 14 November 1995), there were still signs of an international investment banking ambition until the late 1990s. For example, in 1995 Vereinsbank concentrated its treasury business in London, in other words, the focus of these operations shifted away from and Munich and Frankfurt. It even considered setting up a trading centre in New York just for its treasury business (effectively, this is trading for its own account). In the same year, Vereinsbank also opened an office in Singapore to gain a foothold in Asia, where it generated just 5% of its revenues, but aspired to achieve 20% in 2000 (Börsen-Zeitung, 1 December 1995).¹⁷ During this first phase, management said regarding its international investment banking plans that, “in the event of an opportunity, for which there are no plans yet, the bank would rather strike a deal in the US than in the UK” (Börsen-Zeitung, 10 August 1995; Fisher & Urry, FT, 15 December 1995).¹⁸

As these international investment-banking scenarios did not really materialise - not least, because the bank did not buy an Anglo-Saxon investment bank - HVB entered a second phase. During this phase, management began to describe Vereinsbank's failed attempts in the first phase as a “selective investment banking approach” (Dries, Börsen-Zeitung, 3 May 1995; Hellmann, Börsen-Zeitung, 22 July 1997; interviewee II). Presenting past mishaps as “strategy” corroborates the importance of Mintzberg's distinction between *intended* and *realised* strategies. All too often, the realised strategy is presented as the one that was initially intended. In many cases, the discrepancy between intended and realised strategy is hard to measure since there remains more uncertainty about what was really intended than about actual (past) developments.

With hindsight, of course, HVB found itself in the comfortable position that the realised strategy in the first phase appeared superior to the strategy of some of its competitors which had bought Anglo-Saxon investment banks. Some of

¹⁷ Sources of revenue were corporate finance, trade finance, asset management and treasury (Börsen-Zeitung, 1 December 1995).

them subsequently realised that for a universal bank to own and manage a transaction-oriented investment bank is not “a walk in the park”. Therefore, HVB’s second phase continued, this time intentionally, with the notion of a “selective investment banking strategy” (FAZ, 20 September 2002; interviewee I).

In the 1998 annual report management highlighted HVB’s corporate and investment banking activities as core competences. CEO Schmidt said, “We are purposely concentrating on expanding our corporate profile along the lines of our core strengths: real estate financing, structured finance, selected treasury products, and asset management” (HVB, Annual Report 1998). Yet, he also made it clear at the time that HVB did not have any global ambitions and that the intentionally cautious approach to global investment banking would pay off (HVB, Annual Report 1998).

When Schmidt outlined his vision of a European bank with a strong regional flavour, he reiterated that HVB did not want to become a global force in investment banking (Major, FT, 22 February 2000). Because of further streamlining, HVB merged its corporate and markets activities and brought equity and debt-related products closer together (FAZ, 20 September 2002; interviewee I). In the bank’s 2003 annual report management announced that it had successfully completed the strategic switch from a lender to an integrated capital market bank, with specific expertise in the field of structured finance solutions (HVB, Annual Report 2003).

¹⁸ Vereinsbank raised DM 1 billion through a rights issue in spring 1995. At the time, it was suggested that this fresh capital would be used for the bank’s internationalisation and expansion into investment banking (Fisher, FT, 3 April 1995; Dries, Börsen-Zeitung, 3 May 1995).

5.7.2.3. Asset Management

Next to real estate financing and corporate banking, asset management was named as one of the core competences of the newly merged HVB group (HVB, Annual Report 1998). Asset management was already a strategic cornerstone at Hypo-Bank but only played a subordinate role at Vereinsbank. Hypo-Bank owned Hypo Capital Management Investmentgesellschaft (Hypo-Invest) through which it managed its mutual funds (retail funds) and had entered into a joint-venture with the UK institutional fund management house Foreign & Colonial Management (F&C) in 1989. Initially Hypo-Bank owned just 50% of F&C. In 1996 it increased its stake to 65% and finally raised it to 90% in 1999 (Bayerische Hypotheken-und Wechsel-Bank AG, 14 November 1996; Stuedemann, FT, 31 December 1998). Not least due to this cooperation with F&C, asset management became a separate business unit and as such gained a place in Hypo-Bank's annual reports.

By contrast, Vereinsbank's asset management activities¹⁹ were subsumed under "Private Customers". Vereinsbank and Commerzbank jointly owned "Allgemeine Deutsche Investment-Gesellschaft" (Adig), an asset management company that managed assets of around DM 40 billion in 1993 (DM 23 billion fixed income, DM 12 billion equities and DM 5 billion balanced funds, i.e. equities and bonds). Each bank owned 42.7%²⁰ of Adig, which continuously lost market share between 1993 and 1999 (Süddeutsche Zeitung, 20 August 1993; Börsen-Zeitung, 23 February 1999).²¹ In 1999, HVB sold its stake in Adig to Commerzbank, commenting that it intended to merge F&C and Hypo-Invest, which together managed assets totalling DM 200 billion (Börsen-Zeitung, 23 February 1999).

Following the merger, HVB had assets under management of DM 160 billion,

¹⁹ The aforementioned effort by Vereinsbank to acquire US investment bank Oppenheimer in 1995 would have been welcomed by management, as it would have doubled Vereinsbank's assets under management. When the negotiations became public, Schmidt described the move as "a great leap forward", since he felt Vereinsbank, which managed around DM 45 billion of assets, had to catch up in the area of fund management (Funds International / Lafferty, December 1995; The Wall Street Journal Europe, 14 November 1995). Moreover, and possibly of even greater importance, the takeover of Oppenheimer would have facilitated a very necessary knowledge transfer (Funds International / Lafferty, December 1995). The deal did not materialise as the US banking regulators asked Vereinsbank to give up its entire commercial banking operations in the US to comply with the terms of the Glass-Steagall Act (Fisher & Urry, FT, 15 December 1995; Funds International, December 1995).

²⁰ Adig was Germany's oldest fund management company, founded in 1949 by four financial institutions. Vereinsbank joined them in 1951 and Commerzbank became a member one year later (Süddeutsche Zeitung, 17 June 1997). A wide range of insurance companies and several banks held the remaining 14.6% stake (Börsen-Zeitung, 17 June 1997).

²¹ Adig's market share fell from 15.6% in 1993 to 12% in 1999 when it had assets under management of DM 58.1 billion (Süddeutsche Zeitung, 20 August 1993; Börsen-Zeitung, 23 February 1999).

which Schmidt considered to be respectable volume (Börsen-Zeitung, 22 July 1997). However, two-thirds (i.e. DM 100 billion) of these assets came from F&C, in which HVB had a stake of just 65% at the time. Moreover, in 1997 the bank's assets under management still included those attributed to the 42.7% stake in Adig (Börsen-Zeitung, 22 July 1997). With F&C managing such a substantial part of the group's institutional funds, it is somewhat difficult to understand the reasons for the disposal²² of F&C in 2000 (Süddeutsche Zeitung, 23 December 2000).²³

The bank's official explanation for the sale of its institutional asset manager highlighted HVB's new "open architecture" strategy and its focus on the retail market. Under the new name of Activest, its remaining asset management operations²⁴ tried to compete against other mutual funds (retail funds). The idea of an "open architecture" was to gain market share in the German retail fund sector by offering a whole range of third party mutual funds in addition to its own funds (Felsted & Major, FT, 5 September 2000). It was believed that an open architecture strategy would incentivise HVB's asset managers and improve commission income from the sale of mutual funds through the bank's retail network. Yet, it mercilessly revealed that HVB's asset managers were only "second best" (Boerse Online, 1 March 2001; interviewee I).²⁵ At the end of 2003, Activest's market share was just 6%, with EUR 56 billion of assets under management (HVB, Annual Report, 2003).

²² F&C was sold for EUR 667 million (DM 1.3 billion), leading to a realised book gain of EUR 370 million (Süddeutsche Zeitung, 23 December 2000; HVB, Annual Report, 2001).

²³ Neither interviewee could offer a convincing explanation for the sale of F&C.

²⁴ This also comprised Capitalinvest (Bank Austria) and Nordinvest (Vereins- und Westbank).

²⁵ Interview with Andreas Wölfer, head of Activest.

5.7.2.4. Retail Banking

In retail banking, Vereinsbank and Hypo-Bank had in common a multi-brand approach, which continued after the creation of HVB.²⁶ Moreover, both banks showed a strong leaning towards Eastern Europe in general and Eastern Germany in particular. After the fall of the Berlin Wall, Vereinsbank and Hypo-Bank concentrated on expanding into Germany's five new federal states. Hypo-Bank opened up some branches in Eastern Germany under its original name but also launched a low-budget self-service branch network called Hypo-Service-Bank (HSB). HSB offered only a few banking products, relatively attractive interest rates and mainly operated with staffs who were not qualified bankers²⁷ (Süddeutsche Zeitung, 24 March 1993).

In 1993, HSB had 47 branches across Eastern Germany while Hypo-Bank had 64 branches in this region. This compares to 72 Vereinsbank branches in the five new federal states at the time (Süddeutsche Zeitung, 24 March 1993; Börsen-Zeitung, 9 June 1993). By June 1993, three years after German reunification, Vereinsbank had granted loans totalling DM 15.5 billion, while customer deposits came to about DM 5 billion. It speaks volumes that the bank had a share of 18% of the East German loan market but only 9% of the market for deposits (Börsen-Zeitung, 9 June 1993).

Vereinsbank's multi-brand retail banking strategy began with the acquisition of Vereins- und Westbank. In 1990, Vereinsbank bought 75% of Hamburg-based Vereins- und Westbank to be present in northern Germany and therefore extend its geographic reach. Under the name of Vereins- und Westbank, the bank opened its own 13 branches in three East German states: Mecklenburg-Western Pomerania, Saxony-Anhalt, Brandenburg (FAZ, 18 June 1993). In 1996 Vereins- und Westbank also spearheaded a move into the Baltic²⁸ states, thereby supporting Vereinsbank's Eastern European retail banking strategy (FAZ, 2 April 2002). Vereins- und Westbank kept its own name and branding until 2005, when it was fully integrated into HVB.

²⁶ Vereinsbank had a distribution agreement with insurer Victoria since 1990. Following the creation of insurance group ERGO, of which Victoria is part, the distribution agreement was extended to ERGO. ERGO, Germany's second largest primary insurer (retail insurance), belongs to Munich Re, which, in 2001, owned 25% of HVB (Süddeutsche Zeitung, 20 December 2001). Hypo-Bank had a distribution agreement with Allianz.

²⁷ The term "qualified bankers" refers to those who underwent the traditional three-year apprenticeship, qualifying them as "Bankkaufmann" or "Bankkauffrau".

²⁸ The first Baltic office was in the Latvian capital Tallinn (FAZ, 2 April 2002).

Increasing its market share from below 5% of the German retail banking sector was the main rationale for Vereinsbank's decision to launch a direct banking subsidiary, Advance Bank, in 1996 (Börsen-Zeitung, 23 March 1996). Initially, Advance Bank enjoyed the patronage of CEO Schmidt (Börsen-Zeitung, 23 March 1996; Süddeutsche Zeitung, 12 March 1998). Its target group comprised the well-off between the ages of 25 and 50. It was clear right from the beginning that Advance Bank needed to establish its own brand and effectively compete against Vereinsbank. Management believed that during the first year Advance Bank could gain 25,000 clients and that by the year 2000 the number of clients might reach 250,000 (Fisher, FT, 25 March 1996).

After the merger, it emerged that Hypo-Bank's Direktanlagebank (DAB) had a better standing and would be the preferred online bank for the new HVB. DAB was Germany's first direct bank, founded in 1994. By 1999 it had 120,000 clients and held 18% of the German direct banking market (Böhringer, Süddeutsche Zeitung, 3 November 1999). Consequently, Advance Bank was sold to Dresdner Bank in late 1997 (Süddeutsche Zeitung, 12 March 1998).

HVB decided to list DAB on the stock exchange and floated some 30% of the group's capital in 1999 (Die Welt, 16 November 1999; Börsen-Zeitung, 13 November 1999). In the following years, DAB expanded into Austria, Switzerland, Spain, Italy, the UK and France (Börsen-Zeitung, 18 May 2001). In France it bought online broker Self-Trade for EUR 900 million in September 2000 (Major, FT, 23 May 2001), which it sold again at the beginning of 2003 (Börsen-Zeitung, 18 July 2002; Börsen-Zeitung, 24 January 2003).

Vereinsbank also pursued a multi-brand strategy in its private banking segment. Over the years, the bank acquired several small private banking institutions and tried to maintain their traditional identity. For example, it took full control of the Swiss private bank Bank von Ernst in 1994 by acquiring the remaining 50% it did not already own (Parkes, FT, 21 July 1994). Vereinsbank had already bought 50% of Bank von Ernst from Hill Samuel²⁹ in 1993 (Süddeutsche Zeitung, 17 February 1993; Brenner, NZZ, 22 January 1993). Other private banking brands that belonged to Vereinsbank were Bankhaus Maffei (Munich), Bethmann Bank (Frankfurt), Westfalenbank (Dortmund),

²⁹ At the time, Hill Samuel belonged to TSB.

Neelmeyer (Bremen) and Austrian Schoellerbank (Vienna) (Buchholz, *Süddeutsche Zeitung*, 13 June 2001; *Die Presse*, 21 March 1997).

These private banking institutions originally kept their distinct traditional brand (with the exception of Bethmann Bank³⁰), but the multi-brand strategy was abandoned when HVB's management launched "Next Step" in 2001 (HVB, 12 June 2001). "Next Step" was part of the bank's restructuring programme, which entailed the closure of 165 branches, 1,000 job cuts and the introduction of "Hypovereinsbank" as a common brand name for all retail operations (*Süddeutsche Zeitung*, 7 March 2001; *FAZ*, 13 June 2001). In 1999, HVB had already closed down 139 branches, followed by an additional 80 branches in 2000. It also reduced the number of branches in Eastern Germany from 81 to 37 as the economic development of the five new federal states fell short of management's initial expectations (*Süddeutsche Zeitung*, 7 March 2001).

In June 2001, the group had a total of 902 branches in Germany. 612 were HVB branches, 180 Vereins- und Westbank branches and 110 Norisbank branches (Associated Press, 12 June 2001). Vereinsbank bought the consumer credit bank Norisbank and merged it with its existing consumer credit bank Franken WKV in 1997. This deal provided Vereinsbank with a retail network of some 100 branches, serving 370,000 clients, of which 280,000 came from Norisbank. Vereinsbank's loan volume amounted to DM 3.6 billion and deposits totalled DM 5.5 billion (Bayerische Vereinsbank, 18 June 1997). With a pre-tax return on equity of 26% in 2001, Norisbank was one of Germany's most profitable banks at the time and as such, one of HVB's pearls (Retail Banker International, 14 January 2003).

Given Norisbank's profitability and its niche position in the attractive German consumer credit market, the disposal of Norisbank in 2003 reveals how stretched its situation was. Albrecht Schmidt's successor, Dieter Rampl, tried to explain the sale of Norisbank with the relatively unconvincing argument that it no longer fitted into the group's strategy. However, he also conceded that the sale of Norisbank was an important measure to raise HVB's tier 1 ratio (*Süddeutsche Zeitung*, 17 July 2003). Interviewee II commented upon being

asked why Norisbank was sold as follows: "Well, the bank simply needed money... it just needed money" (interviewee II). At the time of the sale, Norisbank had around 500,000 customers, 1,100 employees and 100 branches (Retail Banker International, 14 January 2003).

Further evidence of the bank's tight capital position is the partial IPO of Bank Austria in the same year. The sale of 22.5% of Bank Austria occurred less than three years after HVB had acquired it for EUR 7.8 billion (Frey & Major, FT, 24 July 2000). Through the acquisition of Bank Austria, HVB had become the majority owner of Creditanstalt as Bank Austria had bought a 69% stake in this bank in 1997 (Neue Zürcher Zeitung, 13 January 1997). Through Creditanstalt,³¹ Bank Austria was able to make further inroads into several Eastern European countries³² (Hall, FT, 16 September 1996).

The takeover of Bank Austria was above all a boost for HVB's retail banking business and paved the way for Schmidt's strategy of a "European bank of the regions". At the heart of the deal was the idea of creating a network of banks with regional characteristics that would share a group-wide transaction platform. Following the deal, the combined bank held a 15% share of the market in southern Germany, 25% in Austria and more than 10% in Poland.³³ It also gained sizeable market shares in the Czech Republic and Hungary (Frey & Major, FT, 24 July 2000).

The rationale for expanding into Eastern Europe was the economic growth potential of these countries, which were expected to join the European Union in the near future. Moreover, these countries had a far lower density of banks than Western Europe. On average, there were 1,700 inhabitants per bank branch in Western Europe in 2000, compared to 11,000 in Central and Eastern Europe (Hall & Reed, FT, 8 August 2000). Following the takeover of

³⁰ Bethmann Bank belonged to Hypo-Bank, which had taken full control of it in 1983 (it first bought a 50% stake in 1976). In 2003, HVB merged Bethmann Bank with Maffei Bank and subsequently sold it to the Dutch banking group ABN Amro.

³¹ Creditanstalt was founded in 1855 at the initiative of the Vienna branch of the Rothschild Bank.

³² During the heyday of the Austro-Hungarian Empire, Creditanstalt operated the biggest banking network in central and eastern Europe (Hall & Reed, FT, 8 August 2000).

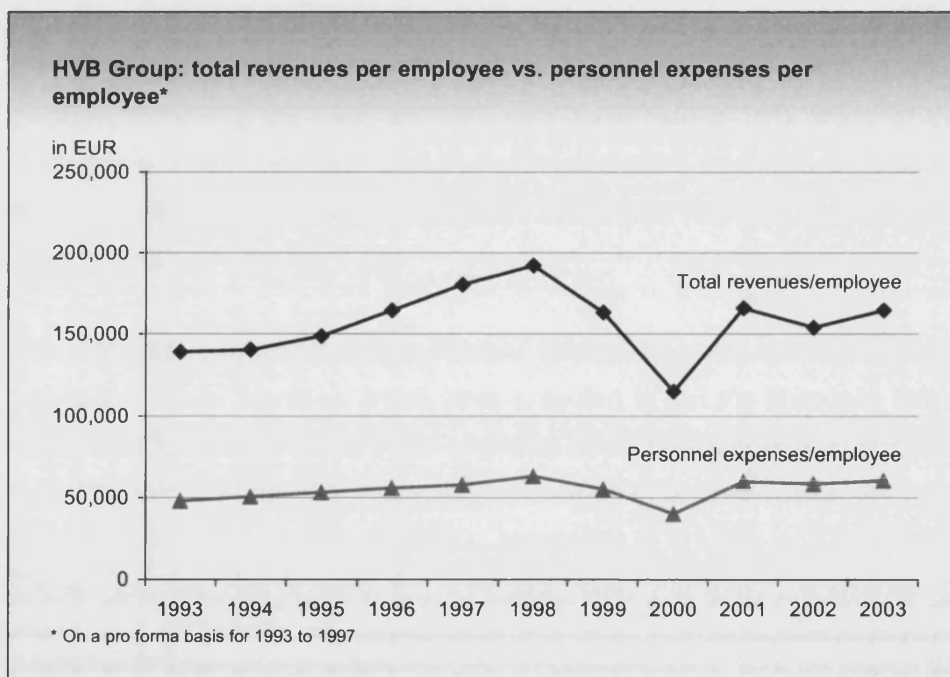
³³ In particular, Bank Austria's exposure to the Polish banking sector proved complementary for HVB as Bank Austria already owned 57% of Warsaw-based Powszechny Bank Kredytowy (PBK), as well as the Polish subsidiary of Creditanstalt. PBK was strong in the north of Poland, while HVB's Krakow-based Bank Przemyslowo-Handlowy (BPH) was strong in the country's south (Frey & Major, FT, 24 July 2000). In October 1998, HVB bought a 37% stake in the sixth largest Polish bank, Bank Przemyslowo-Handlowy SA (BPH). BPH had 1 million private clients, served through 170 branches and 6,200 employees. Schmidt announced that HVB planned to increase its investment in BPH to above 50% and that the bank would

Bank Austria, HVB had a total of 8 million customers, 2,000 retail branches and 65,000 employees (Frey & Major, FT, 24 July 2000). At the time, management estimated that cost savings amounted to EUR 500 million (Frey & Major, FT, 24 July 2000). Although there is no clear evidence that HVB realised the cost savings announced, the following section will argue that operating costs were not the principal reason for its weakened position.

maintain its original brand name (Süddeutsche Zeitung, 23 October 1998). In 2003, HVB raised its stake to 71% (Süddeutsche Zeitung, 23 May 2003).

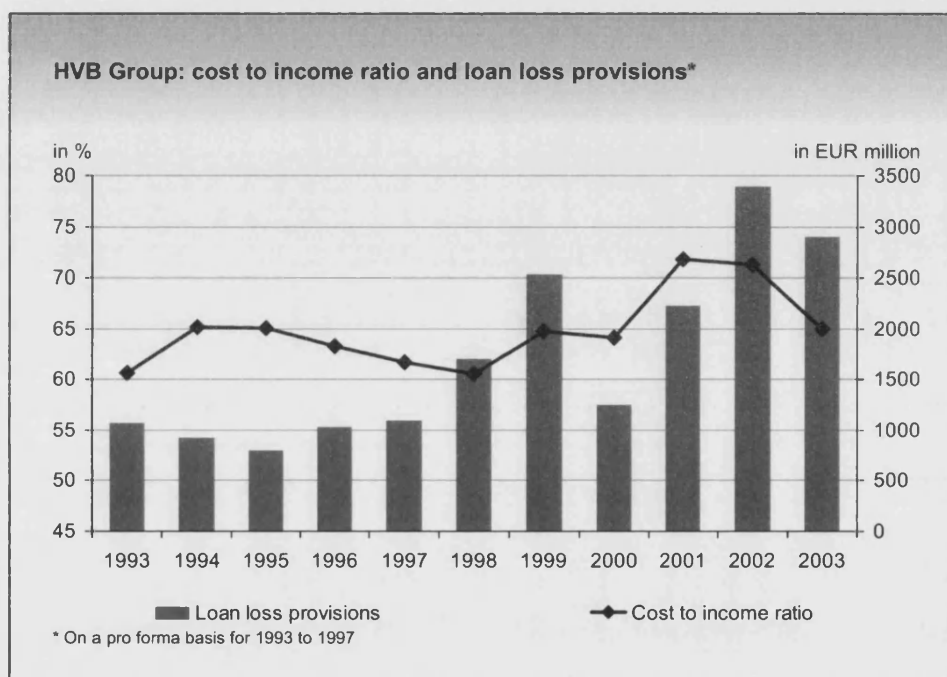
5.7.3. Cost and Risk Management

The proportion of personnel expenses relative to the bank's total operating expenses before risk provisions was on average 54%. This ratio remained within a narrow band, fluctuating between 56.6% in 1993 and 50.1% in 2001. In 2003 it was 56.3%, more or less the same level as ten years previously. The relatively stable ratio suggests that HVB could not realise significant scale efficiencies despite increasing total operating income by 78% during the period analysed (2003 versus 1993). Moreover, this cost structure lends credence to the argument that personnel expenses were not the essential factor behind HVB's deplorable profitability. The bank's average cost income ratio of 65% corroborates this view. Still, in 2002, management decided to shed at least 9,100 jobs (Buchholz, *Süddeutsche Zeitung*, 26 July 2002; AFX, 18 February 2003), further reducing HVB's headcount from its peak in 2000, when it still employed 72,867 people (Major, 18 October 2001).



In 1993, Vereinsbank and Hypo-Bank together employed 40,056 staff. That compares with HVB's headcount of 60,214 in 2003. Obviously, the largest boost came from the acquisition of Bank Austria, which added some 19,000 employees to the group (HVB, Annual Report 2000; Gemperle, *NZZ*, 24 July 2000). HVB's total personnel costs per employee rose by a moderate

compound annual growth rate of 2.4% during the period analysed. However, revenues per employee grew more slowly, namely, by just 1.7% p.a. The bank's personnel expenses remained under control, not least because the institution abandoned its international investment banking endeavours after a relatively short time. However, HVB's staff did not prove to be the distribution powerhouse management made investors believe (Hoymann, Metzler Equity Research, 16 October 2000). The decline in pre-tax profit before loan losses per employee also illustrates the low efficiency of HVB employees. In 1993, this figure was still EUR 55,120, but by 2003, it had fallen to EUR 12,755.



While HVB's staff was neither a persuasive sales force nor a distorting cost factor, the bank's real shortcoming was its inability to adequately assess risk. The development of HVB's loan loss provisions and coverage ratio pinpoints this weakness. Although HVB did not grant inadequately priced loans to corporate clients in return for investment banking mandates (at least not to such an extent as some of its competitors), the merged bank's loan portfolio became the principal reason for its low earnings. On average, HVB generated 67% of its total operating income from interest-bearing activities. The bank's transformation services are reflected in the size of its balance sheet, including a loan portfolio that was one the biggest in Europe in 2001/2002 (Böhringer,

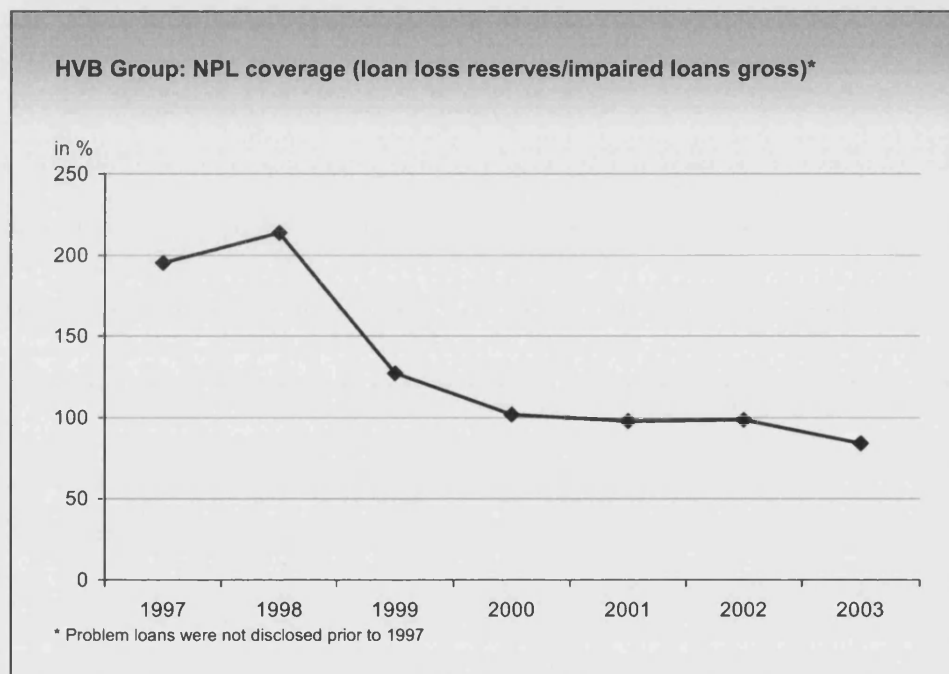
Süddeutsche Zeitung, 24 October 2002). Thus, HVB's profitability hinged upon its ability to manage its credit risks.

As discussed in the section on income structure, Vereinsbank and Hypo-Bank had low net interest margins due to their high proportion of mortgages which at the time were considered to be low-risk loans. Furthermore, the two banks' focus on the same region is likely to have increased unrecognized cluster risks. Additionally, both institutions had rapidly built up an East German loan portfolio (The Economist, 5 August 2000). Vereinsbank's annual loan loss provisions relative to its net interest income was 17.8% between 1993 and 1997. This compares to 26.8% at Hypo-Bank for the same period.

Management's announcement in October 1998 that the newly merged bank would have to raise risk provisions to DM 3.5 billion (EUR 1.8 billion) for the year has to be seen against the background of Vereinsbank's arguably better risk management (The Economist, 5 August 2000). In the end, the bank's 1998 loan loss provisions came to EUR 1.7 billion, 56% above the previous year's level. This was necessary to cover overvalued real estate projects in Eastern Germany, which predominantly stemmed from Hypo-Bank's portfolio. In the early 1990s, the bank had granted loans on incorrect assumptions about economic growth in the five new federal states. Shortly after the need for these provisions became apparent, Vereinsbank's CEO Albrecht Schmidt was quoted as saying: "The discovery of these risks shocked me deeply because I couldn't imagine a mistake of this magnitude [...]" (Barber, FT, 29 October 1998).

Schmidt argued that Vereinsbank had been legally banned from carrying out a fully-fledged due diligence until 1 September 1998 when the merger became official. This led to a serious public quarrel between Martini and Schmidt which culminated in Martini accusing Schmidt of being unfit to run a bank (Barber, FT, 25 October 1999; Süddeutsche Zeitung, 29 October 1998; Barber, FT, 29 October 1998; Süddeutsche Zeitung, 31 October 1998; The Economist, 5 August 2000). An inquiry into this incident brought to light that the auditors (KPMG) had indeed alerted Vereinsbank's management about Hypo-Bank's loan loss provisions, which appeared DM 2 billion too low, before the merger was sealed (Süddeutsche Zeitung, 24 November 1998). Therefore, Schmidt's surprise was mere affectation.

The merger of Vereinsbank and Hypo-Bank was the single most challenging development from a cost and risk management perspective. Management said, the two banks could jointly generate cost savings³⁴ of around DM 1 billion p.a. five years after the merger (Sen, Metzler Sector Insight, 24 July 1998).³⁵ This contrasts to one-off integration costs of DM 1.3 billion, according to management's estimates at the time (Börsen-Zeitung, 22 July 1997). Irrespective of all these potential operational cost savings, the bank's profitability depended on the quality of the bank's loan portfolio. Given the two banks' structural similarities, merging their loan portfolios is unlikely to have improved diversification.



Unfortunately, there is no data available for the NPL coverage ratio prior to 1997, which might have shed some light on the provisioning policy of Vereinsbank and Hypo-Bank. However, the picture after the merger shows the continuous deterioration of the bank's coverage ratio, which fell from 196% in 1997 to 84% in 2003. While the two banks' did not disclose their coverage

³⁴ At the time of the merger, Vereinsbank had 20,475 employees and 711 branches, while Hypo-Bank had 18,083 members of staff and 622 branches. When the merger was announced, the trade union Handel, Banken und Versicherungen (HBV) said it would expect some 6,000 job cuts as there were around 25% overlapping branches in the south of Germany (Börsen-Zeitung, 22 July 1997).

³⁵ 55% of these cost savings were expected to come from reduced personnel expenses, mainly through the layoff of some 5,000 staff members (Koehn, Börsen-Zeitung, 28 August 1998).

ratio for the time before the merger, it is telling that on average 21% of total operating income was eaten up by loan loss provisions (on a pro forma basis). This implies that 32% of the bank's net interest income was spent on loan loss provisions between 1993 and 2003 (on a pro forma basis).³⁶

Towards the beginning of 2002, HVB's management seemed to realise that it had to undertake drastic action to rescue the bank from a situation in which its weakened capital position could mean the loss of its banking licence (interviewee II). The bank's already moderate 6.0% tier 1 ratio at the end of 2001 fell to 5.1% at the end of 2002. If the bank's tier 1 ratio had fallen below 4%, the regulatory authorities could have withdrawn its banking licence (KWG³⁷ §§ 10, 10a, 33; Büschgen & Börner, 2003). Two senior German bankers³⁸ confirmed the severity of HVB's state in 2002 and 2003 and acknowledged that the bank was on the verge of collapse.

In July 2002, management explained that the bad debts provision could total EUR 2.5 billion, up from its initial estimate of EUR 2.1 billion (Buchholz, *Süddeutsche Zeitung*, 26 July 2002). It turned out that this estimate was far too optimistic and unrealistic as loan loss provisions eventually amounted to EUR 3.4 billion in 2002, contributing to a net loss of EUR 850 million. Rightly, management described the year as one of the most difficult banking years since the end of the Second World War (Buchholz, *Süddeutsche Zeitung*, 26 July 2002). HVB suffered particularly badly from its exposure to the *Mittelstand*, and the German real estate market during a phase of economic decline (Cameron, *FT*, 26 July 2002).

Finally, in 2003, HVB addressed the issue of capital adequacy and launched a transformation program. The aim was "to bolster the capital base of HVB Group and make a major improvement to operating performance" (HVB, Annual Report 2003, p. 3). The bank could release capital through the placement of 22.5% of Bank Austria shares and the spin-off of a large part of HVB's commercial real estate finance business.³⁹ HVB transferred its domestic mortgage banking subsidiary and European real estates business to

³⁶ In relative and absolute terms, the bank's biggest loan loss provision was EUR 3.4 billion in 2002, which ate up 57% of the its net interest income for the year.

³⁷ KWG = Kreditwesengesetz (German banking law)

³⁸ The researcher gained these insights from informal personal conversations with senior bankers, who would not wish to be associated with such statements.

the newly formed Hypo Real Estate, which was listed on the stock exchange in October 2003. Besides, HVB scaled back its risk assets through securitisation, the sale of loan portfolios and by simply lending less (HVB Financial Review 2003, p. 5). Moreover, HVB sold Norisbank and Bank von Ernst, generating gains of EUR 468 million (HVB, Annual Report 2003).⁴⁰ Through these measures, HVB reduced its risk assets by EUR 99 billion during 2003.⁴¹

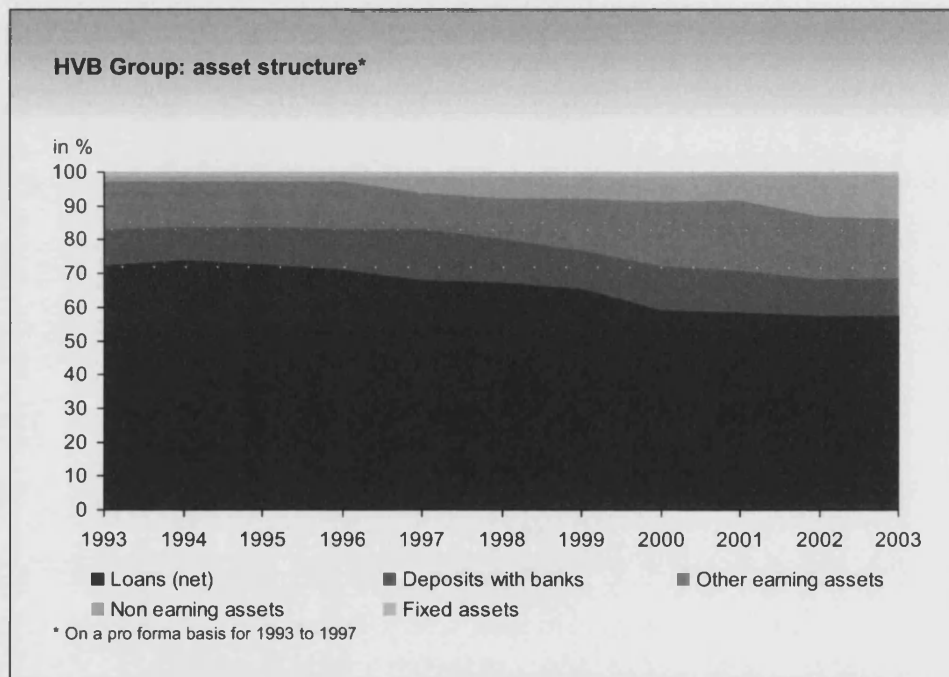
³⁹ Already in February 2001, HVB announced it would begin to bundle its property lending operations in order to found a separate real estate bank at the end of the year.

⁴⁰ Additionally, HVB significantly reduced its shareholdings in Allianz and Munich Re.

⁴¹ HVB expected to generate cost savings of EUR 160 million from 2004 through the establishment of Hypo Real Estate (Süddeutsche Zeitung, 6 February 2001; Major, FT, 6 February 2001). In 2003, Hypo Real Estate employed 1,461 people and had total assets of EUR 153 billion. The bank was well capitalised and its tier 1 ratio stood at 7.6% at the end of 2003 (HVB, Annual Report 2003; Hypo Real Estate, Annual Report 2003). It is somewhat ironic that two years after the listing of Hypo Real Estate, it replaced HVB as a member in the DAX 30 Index, following the takeover of HVB.

5.7.4. Asset-Liability Structure

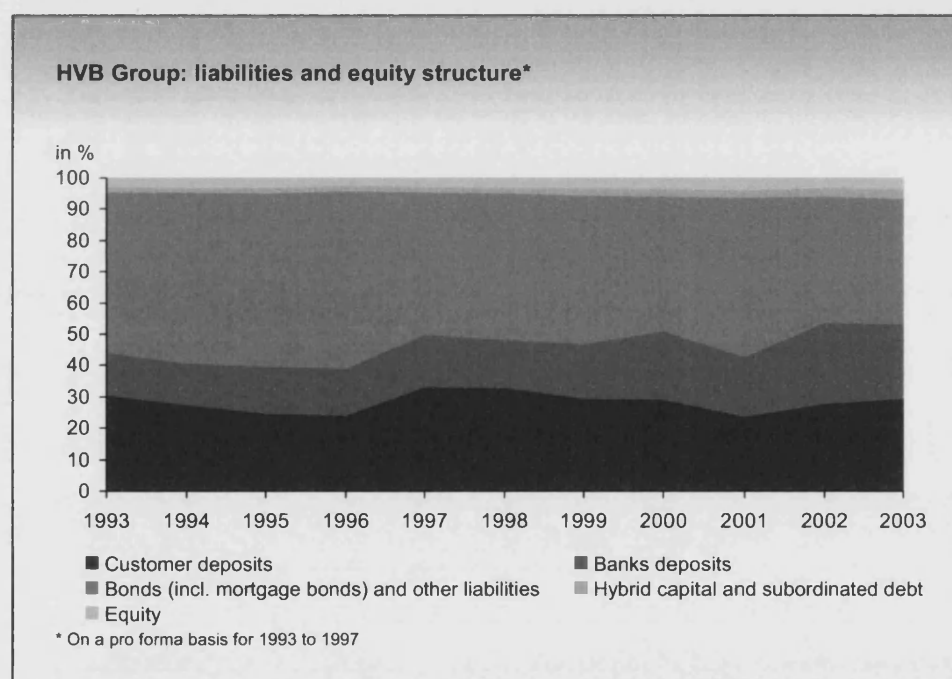
In 1993, Vereinsbank's total assets were EUR 145.2 billion, while Hypo-Bank had total assets of EUR 133.4 billion. At the time of the merger, Vereinsbank's assets were EUR 222.9 billion, of which 72% were loans. Between 1993 and 1997, Vereinsbank's balance sheet grew by a CAGR of 11.3% p.a. Hypo-Bank's assets showed an 8.3% annual growth rate for the same period. Thus, assets at Hypo-Bank amounted to EUR 183.4 billion in 1997, of which 68% were loans. In both cases, the growth in loans clearly exceeded Germany's nominal economic growth rate (GDP), which averaged 3.1% p.a.⁴² Such growth rates suggest that the two banks wanted to gain market share, even at the risk of inadequately pricing loans.



Besides the merger itself, the two largest impacts on HVB's balance sheet structure came from the acquisition of Bank Austria and the spin-off of Hypo Real Estate. In 2000, HVB's total assets rose by 44% (y-o-y) to EUR 694 billion, predominantly due to the takeover of Bank Austria. As a result of the Bank Austria deal, the relative significance of loans declined because the proportion of securities held by the bank jumped by 80% to EUR 83.1 billion. Moreover, HVB's bond portfolio rose by 75% (y-o-y) to EUR 43.6 billion and

some EUR 2.6 billion of goodwill from the Bank Austria deal was added to the balance sheet (HVB, Annual Report 2000). This compares to an increase of customer loans by just 30% (y-o-y) in the year of the Bank Austria acquisition. Consequently, HVB's loan portfolio made up only 59% of HVB's total assets after it had bought Bank Austria.

The spin-off of Hypo Real Estate was one of the cornerstones of HVB's transformation programme in 2003 (interviewee I; interviewee II). This spin-off meant that HVB could reduce its risk assets by EUR 55 billion. Consequently, the bank's core capital ratio rose, alleviating pressure from rating agencies and regulators. In July 2003, HVB's new CEO Dieter Rampl said the bank's target was to lift its tier 1 ratio to 7% by the end of the year⁴³ (Major, FT, 9 July 2003; Börsen-Zeitung, 31 July 2003; HVB, Annual Report 2003).



The bank did not achieve this target in 2003 and, despite additional capital measures such as the EUR 3 billion capital increase in March 2004 (Börsen-Zeitung, 12 March 2004), its tier 1 ratio remained below 7% even at the end of

⁴² 1.6% real GDP growth p.a. for that period (1993–1997).

⁴³ In order to lift the tier 1 ratio to 7%, HVB had to raise its equity base by EUR 1.7 billion (Major, FT, 9 July 2003; Börsen-Zeitung, 31 July 2003).

2005⁴⁴ (HVB, Annual Report 2005). The share price at which Bank Austria was placed valued the bank EUR 1.9 billion below the EUR 7.1 billion acquisition price paid by HVB in 2000 (Kroneck, Börsen-Zeitung, 21 June 2003). Therefore, it should not have come too much of a surprise that HVB had to write down its goodwill from Bank Austria by EUR 800 million in 2003 (HVB, Annual Report 2003).

Comparison of average funding structures at Hypo-Bank and Vereinsbank between 1993 and 1997

in %

	HYPO-BANK	VEREINSBANK
Customer Deposits	26.7	25.2
Banks Deposits	13.8	15.1
Money Market Funding	4.1	0.8
Mortgage Bonds	16.3	18.9
Other Bonds	31.7	33.4
Subordinated Debt	1.4	1.2
Hybrid Capital	0.5	0.2
Other Liabilities	2.6	2.1
Equity	2.8	2.9
Total Liabilities and Equity	100.0	100.0

Comparison of average asset structures at Hypo-Bank and Vereinsbank between 1993 and 1997

in %

	HYPO-BANK	VEREINSBANK
Total Loans - Net	70.1	74.0
Deposits with Banks	12.0	10.2
Due from Other Credit Institutions	4.7	3.7
Total Securities	9.9	9.5
Treasury Bills	0.2	0.1
Equity Investments	0.5	0.4
Cash and Due from Banks	0.5	0.7
Intangible Assets	0.0	0.0
Other Non Earning Assets	1.1	0.8
Total Fixed Assets	1.0	0.8
Total Assets	100.0	100.0

When Vereinsbank and Hypo-Bank merged, their asset and funding structures were in fact quite similar (see table). For example, at both banks just 23% of

⁴⁴ HVB's tier 1 ratio was still only 6.8% in 2005 (HVB, Annual Report 2003). In fact, neither Vereinsbank, nor Hypo-Bank, nor HVB had a tier 1 ratio of more than 6% between 1991 and 2005.

funding came from customer deposits in 1997. The importance of customer deposits as a source of funding had already fallen prior to the merger. In the case of Vereinsbank, it dropped by 7 percentage points and in the case of Hypo-Bank, the decline was even 9.3 percentage points between 1993 and 1997. Yet, both institutions made virtually no use of hybrid financing instruments and the new bank only slowly began to issue subordinated debt after the merger.⁴⁵ While money market funds only played a role at Hypo-Bank, the bulk of funding came from bonds. After the merger, deposits by other banks gained importance, replacing some bond financing. This development suggests that HVB raised a far higher proportion of its refinancing needs on the short-term interbank market.

Since bond financing played such a significant role, the bank's liquidity ratio, measured as net loans relative to deposits does not look too favourable. This ratio illustrates how much of depositors' funding is tied up in lending (Golin, 2001, p. 328). During the period analysed, this ratio never fell below 100%, although it came down from levels of above 180% in the early 1990s (at both institutions) to 108% in 2003. Notwithstanding this liquidity improvement, a ratio of above 100% suggests that HVB's refinancing was highly dependent on the group's rating by international credit rating agencies.⁴⁶ HVB's stretched liquidity position and slim capital adequacy were mirrored by appalling profitability, as discussed in the next section.

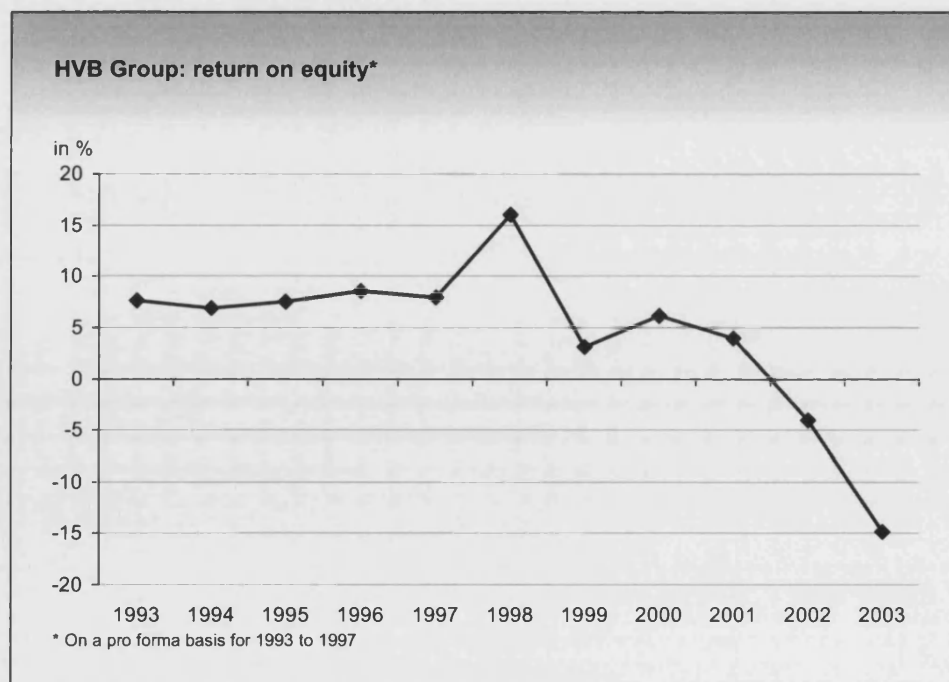
⁴⁵ Hybrid capital and subordinated debt instruments reached their peak at 3% of the group's funding in 2003.

⁴⁶ "We aim to reach a core capital ratio of over 7% and enhance the quality of our core capital at the same time. The capital-raising measure will help us improve our credit ratings and achieve a stable "A" from the three rating agencies relevant for us over the medium term" (HVB, Annual Report 2003, p. 43). In 1998, all rating agencies had double-A long-term ratings. S&P's rating was "AA-". S&P as well as the other rating agencies (Fitch and Moody's) lowered their ratings in the following years, so that S&P's rating was "A-" at the end of 2003.

5.7.5. Profitability

During the period analysed, HVB's stated net profit varied substantially, all too often distorted by significant extraordinary effects. For example, in 1998 it delivered a net profit of EUR 2 billion, boosted by a one-off merger-related consolidation effects of EUR 1.2 billion. In fact, the operating profit fell by 14% (y-o-y) in 1998. Therefore, the underlying profitability implied a return on equity of 6.1%, which CEO Albrecht Schmidt described as unacceptable (Buchholz, *Süddeutsche Zeitung*, 26 March 1999; Hermann, *Börsen-Zeitung*, 10 April 1999).

Understandably, Schmidt had to express his displeasure, as he had declared only eight months earlier that the newly merged bank should deliver returns on equity of at least 15% after tax (AFX, 21 July 1997; *Börsen-Zeitung*, 22 July 1997). However, in the years after the two banks joined forces, HVB's profits remained relatively low. As more and more loans turned sour, the bank finally slipped into loss. For the first time, HVB delivered a loss of EUR 850 million in 2002. In the following year, the bank's loss amounted to EUR 2.4 billion and in 2004 it totalled EUR 2.1 billion. Finally, in 2005, the year when HVB was taken over, this trend could be reversed.



Between 1998 and 2003, the average net profit per year was EUR 214 million. This level of profitability was an average return on equity of just 1.7% (1998-2003). On a pro forma basis, HVB's return on equity for the period between 1993 and 2003 was on average 4.4%. This figure indicates that neither Vereinsbank nor Hypo-Bank was exceptionally profitable on its own. Hypo-Bank's return on equity averaged 8% between 1993 and 1997. At Vereinsbank, the situation was equally unimpressive as its average ROE was 7.8%.

It is worth pointing out that the return on equity could have been even lower if HVB had been better capitalised. As shown, HVB and its predecessor institutions had relatively moderate tier 1 ratios. A stronger capitalisation would have implied a higher equity basis. However, this would not have automatically improved profitability. Therefore, the bank's returns on equity could have been even worse if management had tried to lift its tier 1 ratio, through additional capital measures.

The reasons for the bank's poor profitability largely originated from bad risk management and a weak net interest margin for loans that turned out to be much riskier than initially estimated. The acceptable level of the group's long-term cost income ratio of 65%⁴⁷ corroborates the view that HVB's weak profits were less related to administrative and personnel expenses than to its loan portfolio. Notwithstanding the somewhat good cost income ratio, CEO Schmidt also failed⁴⁸ to meet the cost income ratio target of 50% he had announced at the time of the merger (Koehn, Börsen-Zeitung, 28 August 1998). In fact, HVB's cost income ratio rose towards 70% after the merger. Obviously, Schmidt had wildly underestimated the integration costs and overestimated the scale efficiencies.

⁴⁷ On a pro forma basis for the period 1993 to 2003.

⁴⁸ In all fairness, this mediocrity was also lived up to by the bank's other board members. For example, Wolfgang Sprissler, HVB's current (2006) CEO, was quoted as saying in July 2002: "We live in bad times and it would be untrustworthy to maintain one could forecast the loan loss provisions for the year-end. We are not clairvoyants" (Buchholz, Süddeutsche Zeitung, 26 July 2002). True, bank managers are no clairvoyants and no one expects them to be. However, one could and should expect board members to know their loan portfolio, have an understanding of their clients' financial situation, and be intellectually capable of applying this knowledge adequately in the prevailing macroeconomic context.

5.7.6. Conclusion

Rooted in Bavaria's strong economy, Vereinsbank and Hypo-Bank embarked on an adventurous journey, which ended in Italy seven years after their merger. Once the uneven merger was sealed, Vereinsbank's international profile dominated the new bank and paved the way for its "European bank of the regions" strategy (interviewee II). The idea, a brainchild of Vereinsbank's management, was to build a network of European banks with regional characteristics that share a group-wide transaction platform (Major, FT, 12 May 2000). This concept was not unlike HSBC's successful "world's local bank" approach to international expansion.

At last, there seemed to be a German bank that presented an appealing strategy, a story that journalists, investors, analysts and the likes appreciated (interviewee I; interviewee II). A bank led by a clever leader who first created a regional champion that would then branch out into its neighbouring countries. The countries' different business cycles made Schmidt's strategy even more convincing, as they should have stabilised revenues and profits. HVB presented itself as a bank that did not seem to fall into the investment banking trap with a "me-too" strategy (interviewee I). On the contrary, it cherished not only German, but also Polish, Hungarian and other Eastern European retail clients at a time when many of its peers were busy underwriting equity and pitching for M&A deals. CEO Schmidt portrayed it as a bank with a European vision. In many ways, he was a model for those who called for a pan-European banking approach.⁴⁹

HVB's European strategy appeared convincing and it could have been so different without the incessant problems with the bank's loan book (interviewee I). Vereinsbank and Hypo-Bank merged two inadequately provisioned and similar loan portfolios that could not be conducive to HVB's risk diversification. The loan portfolio, predominantly real estate loans, first depleted the bank's profitability and eventually pushed it into the red for three

⁴⁹ Moreover, there is ample research that shows that "proximity" is a parameter that matters for a successful takeover. "The most successful deals display on average a much stronger home bias and distinctively smaller distance between acquirer and target than the least successful deals. Proximity in M&A transactions therefore is a necessary but not sufficient condition for success" (e.g. Grote & Umber, 2006). The case of the two Munich based banks demonstrated that Grote and Umber are right in pointing out that proximity itself is not sufficient for a successful merger.

consecutive years (2002/03/04). Total losses amounted to EUR 5.4 billion for those years and culminated in the takeover by Unicredit.

Albrecht Schmidt believed Vereinsbank should be present in virtually every major world market (The Wall Street Journal Europe, 14 November 1995). He pressed ahead with the bank's internationalisation as announced when he took office in 1990. His second ambition was to complement the bank's geographic reach and, as previously quoted, emerge from the role of a small regional player. The acquisition of Vereins- und Westbank and expansion into the Eastern German market were milestones in achieving this goal. However, as his third objective, he also committed himself to improving earnings (The Wall Street Journal Europe, 14 November 1995; interviewee II).

Perhaps because earnings were third on his list, they played only a subordinated role. Clearly, profitability is not a strategic objective in its own right and all strategy should serve to improve profits and the quality of profits.⁵⁰ It is remarkable that the chief executive of a large publicly traded bank could stay at the top of such an institution for so long despite repeatedly missing profit targets. An average return on equity of 6.6% between 1990 and 2002, i.e. during Schmidt's tenure, certainly did not cover the bank's cost of equity. It therefore raises questions about the role of the supervisory board and corporate governance in Germany during the 1990s.

The HVB case demonstrates that a well sounding strategy alone is not sufficient for a bank's success. Analogously to the skills of an artisan, a bank's strategy must begin with a thorough understanding of its trade. For a bank, that is risk management. This holds true for banks that focus on transformation services just as much as for those that are transaction-oriented. HVB's case also demonstrates that even if the intended strategy becomes the realised strategy, this is not necessarily in the best of interests of stakeholders and shareholders. The HVB experience, not to say experiment, should make CEOs wary of talking too explicitly about strategy, unless they can be certain about their skills. If the company successfully generates stable risk-adequate profits and remains

⁵⁰ "Quality" refers to stable, risk adequate and therefore sustainable profits.

competitive among its peers, then with hindsight, any corporate development is likely to be commended as having had a good strategy.

5.8. Lloyds TSB plc

5.8.1. Introduction and Status Quo in 1993

Lloyds Bank, which became Lloyds TSB when it merged¹ with the Trustee Savings Bank (TSB) in 1995, can look back at a long corporate history rich in international experience.² Founded in Birmingham in 1765 by John Taylor and Sampson Lloyd, the bank became a joint stock company in 1865 and thereafter expanded across England and Wales, primarily through mergers and acquisitions. In 1911 Lloyds Bank bought Armstrong & Co. in Paris and Le Havre and only seven years later it moved into the South American banking market (Sayers, 1957; Winton, 1982; Rogers, 1999).

Throughout the 1960s and 1970s Lloyds continued to internationalise its retail and wholesale business. This included the purchase of a majority stake in National Bank of New Zealand (1966), and the acquisition of the Bank of London South America (1971). Lloyds' international operations were brought together in 1974 under the newly formed Lloyds Bank International (LBI), which was merged into Lloyds Bank in 1986 (Lloyds TSB, Lloyds TSB Group History, 2005³). On the European continent, Lloyds bought a small minority stake in the traditional private bank Schröder Münchmeyer Hengst (SMH) in 1983 which it increased to 91% in 1985.

At the peak of its expansion spree in 1984, Lloyds operated a branch network around the globe and was present in 47 countries (Rogers, 1999; Bátiz-Lazo & Wood, 2000). Despite this diverse early international experience, Lloyds Bank had largely withdrawn from most of its international operations and developed into a domestic retail and small business bank by the time the Single European Market was created in 1993. The reasons for Lloyds' strategic shift and the focus on its home market can be explained mainly by its exposure to the international debt crisis of the early 1980s and the arrival of a new chief executive, Brian Pitman.

¹ Given that Lloyds was much bigger than TSB in terms of assets, employees and market capitalisation, this deal can be described as a takeover of TSB.

² Throughout this research "Lloyds Bank", "Lloyds TSB" and "Lloyds" will be used interchangeably without any historical reference.

Lloyds' Latin American portfolio could not escape unscathed from the implications of the debt crisis that began in Mexico⁴ in August in 1982 and spread throughout the whole South American continent in the following years (Federal Deposit Insurance Corporation, 2000). Lloyds' senior management described Mexico's announcement that it was defaulting on its debt as the turning point for the bank's international strategy (Rogers, 1999, p. 49). In the following year Pitman, who had joined the bank in 1953 and spent some time in its international divisions, was appointed as the bank's CEO. Under his leadership, Lloyds scaled back its international activities and concentrated on its domestic market.

From 1983 to 1997 Pitman served as the bank's chief executive, then became chairman, a post he took over from Sir Robin Ibbs (1993-1997) and held until 2001. TSB's former CEO, Peter Ellwood succeeded Pitman as Lloyds TSB's chief executive and remained at the helm of the bank until June 2003. Subsequently, Eric Daniels, an American born to German and Chinese parents, assumed the leadership of Lloyds TSB (Croft & Pretzlick, FT, 16 April 2003). The choice of Dutchman Maarten van den Bergh as chairman in 2001 paved the way for greater internationalisation of the board following the turn of the millennium.⁵

18 years as CEO allowed Pitman to shape the group's strategy and manage the institution through various business cycles. He transformed Lloyds from a small clearing bank with exposure to heavily indebted Latin American countries, into a multiproduct, multiregional and multicustomer retail financial services firm in the UK (Rogers, 1999, p. 46). At the heart of Pitman's strategy was his belief that a company should be managed to create shareholder value and thus forego growth opportunities for profitability. As a result of this highly focused strategic understanding Pitman began trimming back operations that did not meet the required return on equity.

For example, Lloyds sold Lloyds Bank California in 1986, closed down its branches in the US and in 1992 it ended the investment banking endeavour it

³ Lloyds TSB (2005). Lloyds TSB Group History [online]. London: Lloyds TSB. Available from: <http://www.investorrelations.lloydstsb.com/gr/history.asp> [Accessed 12 April 2005].

⁴ As a result of the LDC crisis some big corporations enjoyed better credit ratings than the banks they had borrowed from, contributing to the general disintermediation trend (Bátiz-Lazo & Wood, 2000).

⁵ According to Jochen Neynaber "Lloyds lost its Englishness through the arrival of these new board-members, not necessarily to its advantage" (interview Jochen Neynaber).

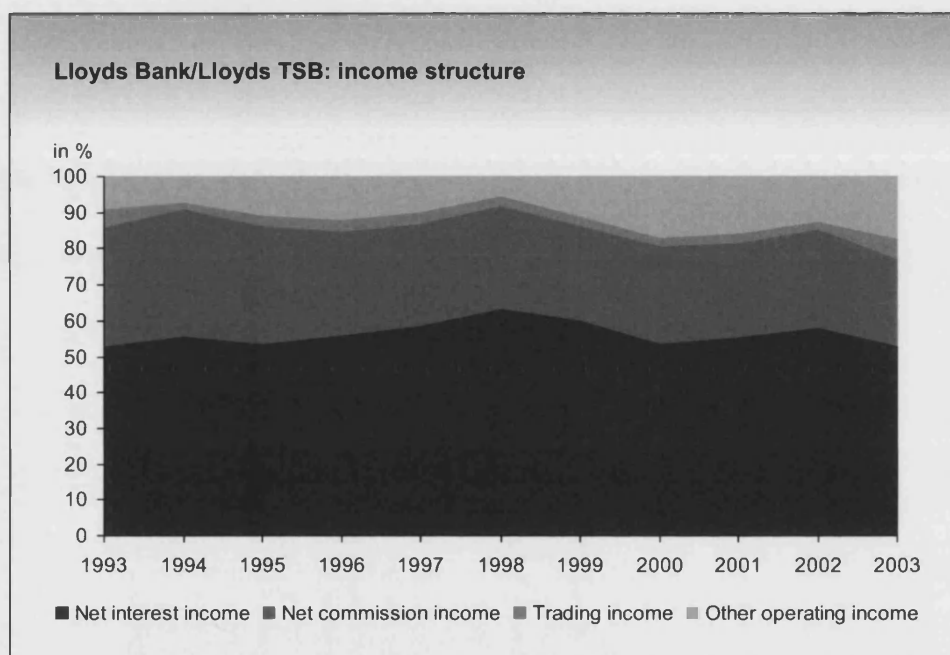
had introduced in 1978 (Rogers, 1999; Báltiz-Lazo & Wood, 2000). Lloyds also exited the Portuguese banking market in 1990, where it had been present for 128 years⁶ (FT, 19 June 1990). While cutting back its international operations, the bank stepped up its UK business. Prior to 1993, its most prominent move to expand in the UK was through the acquisition of a majority stake (60%) in Abbey Life in 1988 (The Economist, 13 June 1992).

⁶ The 12 branches were sold to Spain's Banco Bilbao Vizcaya (FT, 19 June 1990).

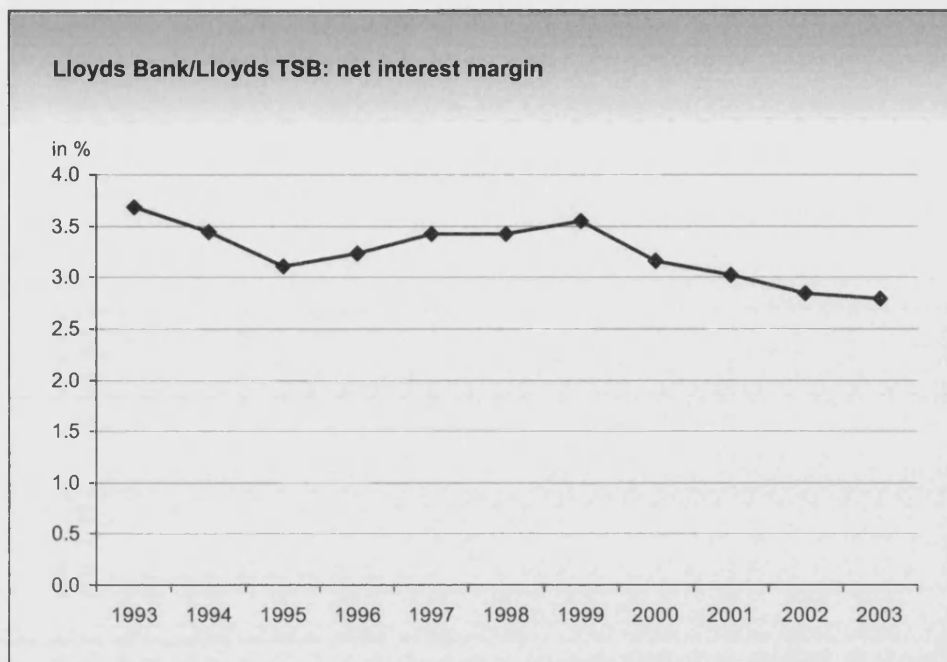
5.8.2. Income Structure

5.8.2.1. Structural Overview

Lloyds' income structure did not change notably between 1993 and 2003. On average, Lloyds' operating income grew by 9.5% p.a. during the period analysed. In absolute terms, its total operating income more than doubled from GBP 4.0 billion in 1993 to GBP 9.9 billion in 2003. Lloyds' focus on retail banking is reflected in the relatively high proportion of total operating income coming from net interest income.



On average 57% of the bank's operating income originated from lending and deposit-taking activities and was therefore booked as net interest income. Although Lloyds' net interest income remained the biggest source of income, it still suffered from the decline in its net interest margin. This narrowing of the net interest margin was offset by a compound annual growth rate of 9.5% for net interest income from 1993 until 2003. Effectively, net interest income rose from GBP 2.1 billion in 1993 to GBP 5.3 billion in 2003 as a result of the bank's growing balance sheet.



The proportion of income from commission declined from 33% in 1993 to 24% in 2003. The relative decline in commission and net interest income arose from the greater significance of the bank's other operating income as a result of Lloyds' bancassurance strategy and the rise in premium income, which comprised most of this item. While trading gained importance during the period analysed, growing by 10.5% p.a. (CAGR), the overall proportion of trading income remained comparatively low. As Lloyds was not active in investment banking, trading only contributed on average 3.2% to its total operating income.

Lloyds had already undergone a major strategic revamp in the 1980s when management decided to scale back the bank's international operations and concentrate on retail clients in its home market. By the time the European Common Market was launched, Lloyds had already embarked on a strategy that it consistently pursued during the following 10 years. Therefore the following analysis will concentrate primarily on the bank's retail banking business and offer only a brief account of Lloyds' investment/corporate banking activities and asset management operations.

5.8.2.2. Corporate and Investment Banking

Between 1993 and 2003 an average of 35% of Lloyds' profits before tax came from wholesale operations. While corporate banking services⁷ were offered to institutional clients throughout this period, Lloyds had already abandoned transaction advisory services, i.e. investment banking, in 1992. During the late 1970s and 1980s Lloyds Bank, the traditional UK clearing bank, made various attempts to expand into international investment banking (Rogers, 1999, p. 48; Bátiz-Lazo & Wood, 2000). However, unlike most of its UK competitors, it began to withdraw from investment banking shortly after the Big Bang in 1986. In 1987 Lloyds closed down its gilts and Eurobond trading but kept its corporate finance operations, the asset management division, and its stock-broking arm (Bennett, *The Times*, 20 October 1992).

Finally, at the end of 1992 the bank dissolved Lloyds Merchant Bank (LMB). This entailed the closure of its corporate finance business and integrating its stock-broking, asset management and venture capital divisions into the Corporate Banking and Treasury division (Lloyds Bank, Annual Report 1992; Barchard, *FT*, 20 October 1992; Bennett, *The Times*, 20 October 1992). Lloyds Merchant Bank was not a major contributor⁸ to group earnings and the decision to exit international investment banking underlined Lloyds' strategic focus on the British market. Subsequently, Lloyds served corporate clients in the UK primarily through its Wholesale Markets division (formerly the Corporate Banking and Treasury division) and the International Banking division.

Management pulled out of investment banking at a time when other British banks were still indulging in a kind of post-Big Bang hype. Exiting investment and international corporate banking appears with hindsight to have been a proactive move.⁹ Yet, it should be pointed out that others considered the decision to leave investment banking as a reaction to Lloyd's failed bid¹⁰ for

⁷ Corporate banking services were for example, treasury, large value lease finance, long-term agricultural finance, share registration and factoring (Lloyds TSB, Annual Report 2003).

⁸ In fact, LMB delivered a pre-tax loss of GBP 21 million in 1992 after GBP 1 million pre-tax profit in 1991 and GBP 10 million in 1990, i.e. less than 2% of the bank's pre-tax profits (Lloyds Bank, Annual Report 1992).

⁹ Jochen Neynaber, Member of the Executive Committee of Lloyds Bank from 1985 until 1997 and Chairman of Schröder Münchmeyer Hengst & Co, recalled the words with which Brian Pitman described the closure of Lloyds Merchant Bank. He said: "Investment banking, all my colleagues are in the concrete up to their hips, I am only in there up to my ankles, so at the loss of my shoes I am gonna get out of it" (interview Jochen Neynaber).

¹⁰ In April 1992, Lloyds announced a GBP 3.7 billion bid for Midland Bank. Ultimately Midland fell to HSBC, which had already owned a 15% stake in Midland Bank since 1987. According to Lloyds the deal would

Midland Bank in 1992. At the time it was argued that if Lloyds had succeeded, it would have merged LMB into Samuel Montague, Midland's well-positioned merchant bank (Bennett, *The Times*, 20 October 1992).

Only three years later Lloyds again found itself exposed to investment banking after the merger with TSB which included the merchant bank Hill Samuel which TSB had bought in 1987 (Denton & Harverson, *FT*, 10 October 1995). Hill Samuel was not particularly profitable and results were depressed by high loan loss provisions for its property lending business (Blanden, *The Banker*, 1 March 1993). Following the merger with TSB, Pitman said Lloyds would want to hold on to some of Hill Samuel's businesses. He explicitly expressed his interest in private banking and fund management, but did not specify the future of the corporate finance arm (Gapper, *FT*, 12 October 1995). Therefore, it was of little surprise that Lloyds TSB sold the corporate finance department of Hill Samuel a year later but kept the commercial and private banking operations (Atkins, *FT*, 1 June 1996).

Management's decision to sell its German merchant bank Schröder Münchmeyer Hengst (SMH) took somewhat longer. In fact, the sale of SMH was triggered by SMH's chief executive Jochen Neynaber. Although SMH was a highly-regarded private bank which focused on serving investors in the German bond and equity markets (Lloyds Bank, *Annual Report 1993*), Neynaber believed that the size and momentum of US investment banks would not leave enough room for a German niche player (interview Jochen Neynaber). In August 1997 Lloyds TSB announced the sale of its 90% stake in Schröder Münchmeyer Hengst, explaining that the German bank no longer formed part of its core business.¹¹

Despite its apparently clear strategic focus on domestic operations, Lloyds did not sell its other international businesses until the 2003 strategic review. Eric Daniels succeeded Peter Ellwood as CEO on 31 May 2003 and presented the results of his strategic review in October of the same year. Lloyds TSB's new strategy foresaw the re-invigoration of its UK franchise and therefore paved the way for a reduction of the bank's international activities (Lloyds TSB

have allowed cost-savings of GBP 700 million, primarily by cutting 20,000 jobs and shutting 800-1,000 branches (*The Economist*, 2 May 1992).

¹¹ UBS paid DM 350 million (GBP 110 million) for SMH, which Lloyds had bought in 1984 as a turnaround case.

Presentation, 5 November 2003; Sheridan & Napier, 2005). In the following months the majority of Lloyds TSB's international businesses were sold. These comprised, first and foremost, the disposal of National Bank of New Zealand in October 2003 for GBP 2.25 billion, which led to a net capital gain of GBP 1.1 billion (FT, 25 October 2003). Thereafter, Daniels also disposed Lloyds' Latin American businesses and the group's French private banking and fund management businesses.

5.8.2.3. Asset Management

Asset management at Lloyds was primarily an integral part of the bank's bancassurance strategy for its retail operations and to a lesser extent a stand-alone fund management arm. Therefore Lloyds did not disclose figures for a distinct asset management segment. Instead it consolidated these activities in its Insurance and Investments segment (from 1998). The Insurance and Investments segment comprised Abbey Life and the bank's Edinburgh-based life assurance company Scottish Widows and Scottish Widows Investment Partnership (SWIP), which it had bought in 1999.

The merger with TSB added new momentum to Lloyds' fund management activities through Hill Samuel's substantial asset management division. After the merger with TSB Hill Samuel formed the nucleus of the group's new fund management operation. Following the acquisition of Scottish Widows, Lloyds TSB's management integrated its Hill Samuel asset management unit into Scottish Widows and transferred Hill Samuel's asset management arm from London to Edinburgh. At the time Hill Samuel had GBP 55 billion assets under management while Scottish Widows managed GBP 35 billion (Targett, FT, 1 March 2000). The decision to relocate the fund management business to Scotland led to an exodus of asset managers from Hill Samuel (Croft, Orr & Nichol, FT, 27 September 2003).

SWIP managed funds for Lloyds TSB's retail life, pensions and investment products, but also served institutional clients such as corporate pension schemes and local authorities (Lloyds TSB Annual Report, 2003, p. 11). Although management expressed its interest in becoming a global player in asset management (Targett, FT, 1 March 2000), Lloyds TSB's asset management activities remained an integral part of its retail banking activities and did not achieve the size and the status of a leading global asset manager. In fact, SWIP's total assets under management were less than GBP 77 billion at the end of 2003, compared to GBP 90 billion when Scottish Widows and Hill Samuel were merged in 2000.

5.8.2.4. Retail Banking

When Pitman made a hostile takeover bid for UK rival Midland Bank in 1992 he left little doubt that he considered Lloyds' future to be in the domestic retail market and that a higher market share was essential to improve profitability. However, Midland was acquired by HSBC and Lloyds had to consider other options. Finally, in April 1994, Lloyds approached Cheltenham & Gloucester (C&G), the mutual building society where Pitman had started his banking career in the early 1950s.

C&G was Britain's sixth largest building society and its cost income ratio of 26% suggested it was one of the most efficient players in the market; the industry average was just under 50% (The Economist, 23 April 1994). The acquisition of C&G proved a cumbersome and slow undertaking as it had to be demutualised before Lloyds could buy it. Lloyds was the first British bank to take over a building society and thus paved the way for a new consolidation wave in the UK financial services industry (The Economist, 23 April 1994).

According to the 1986 Building Societies Act it was not allowed to make a cash offer to people who had been members of C&G for less than two years. This Act was intended to avoid "speculative flows" of deposits between building societies if a takeover scenario were in the offing (The Economist, 23 April 1994; Gapper & Mason, FT, 9 June 1994). C&G needed 75% of its 825,000 members' approval for a takeover. However, 27% had been with the building society for less than two years in 1994 (Gapper & Mason, FT, 9 June 1994). Finally, Lloyds paid the society's members GBP 1.8 billion in cash in return for voting to abandon mutual status in April 1995 (The Economist, 23 April 1994; Gapper & Mason, FT, 9 June 1994; Smith, FT, 1 April 1995).

In October 1995 Lloyds already announced another deal that would boost revenues and strengthen the bank's position as the driving force in the British retail banking market. Lloyds pursued a GBP 15 billion merger with the Trustee Savings Bank (TSB), which created the most extensive high street banking network in the UK with 2,850 branches and more than 12 million customers (Denton & Smith, FT, 10 October 1995; Lloyds TSB, Annual Report 1995). Although it was legally a merger, the relative size of the two companies suggested that it was de facto a takeover of TSB by Lloyds. After the merger, former Lloyds' shareholders held 70% of the new group's shares while former

TSB shareholders held 30%. The acquisition of C&G was generally considered as revenue-led, whereas the merger with TSB focused on cost savings (Linnell, *The Banker*, 1 January 2000).

Lloyds and TSB estimated that they could save about GBP 350 million a year by 1999, which would be around 10% of their combined costs. When the merger was announced, management said it would want to keep most of the new group's 2,850 branches but would have to reduce the number of staff. However, Lloyds and TSB had to wait until an Act of Parliament was passed before they were allowed to merge their branches, exchange data and transfer customers from one institution to another (Gapper, *FT*, 12 October 1995). Because of this legal obstacle, Lloyds and TSB had to remain separate identities¹² until 1999.

Pitman emphasised the benefits for British retail banking clients in his arguments in favour of the merger, as the newly formed bank would be able to offer financial products at lower rates due to a reduction in unit prices (Gapper, *FT*, 12 October 1995). Alongside the scope for cost synergies, the deal offered complementary revenue sources. TSB was stronger in the North of England and in Scotland, whereas Lloyds had a better presence in the South of the UK (Denton & Smith, *FT*, 10 October 1995). The deal was not only a good geographic fit, it also made sense from a product perspective. Pitman explained that the merged bank would operate specialist providers for a variety of products, which would be sold under the most appropriate brand name (Smith, *FT*, 12 October 1995).¹³

Combining savings and insurance products were at the heart of the bancassurance model. Lloyds originally embarked on a bancassurance strategy when it bought a majority stake in Abbey Life in 1988. In 1995 it owned 62% of Lloyds Abbey Life (LAL), which comprised Abbey Life and Black Horse Financial Services, while TSB had a life insurer and a motor finance division (UDT). According to Lloyds' management, the integration of Lloyds and TSB's bancassurance models posed the greatest challenge of the merger (Smith, *FT*, 12 October 1995). Through the minority buy-out of LAL in

¹² The first joined branch of Lloyds and TSB was opened in Salisbury in August 1997 (Graham, *FT*, 2 August 1997).

¹³ According to this reasoning, Hill Samuel emerged as the group's private banking and fund management arm.

September 1996, which valued LAL at GBP 4.5 billion, management was able to overcome some of the integration difficulties and underline its clear commitment to the group's bancassurance approach. Pitman reiterated the bank's expansion plans for its insurance operations through organic growth and acquisitions (Graham, FT, 24 September 1996).

Lloyds TSB's bancassurance approach received further impetus from the acquisition of Scottish Widows, the UK's sixth-largest life insurer, in June 1999 (Lloyds TSB Presentation, 23 June 1999). Lloyds paid in total GBP 7 billion¹⁴ for this Edinburgh-based mutual life insurance and pension group and doubled the bank's share of the life insurance and pension markets to 7.2% (Linnell, *The Banker*, 1 January 2000). The deal did not allow for annual cost savings of more than GBP 60 million, but Scottish Widows' strong position as an independent financial adviser helped Lloyds enhance its distribution capabilities (*The Banker*, 1 July 1999). Although Scottish Widows was said to have escaped largely "unscathed from the pensions mis-selling scandal that has devastated the reputations and balance sheets of much of the UK life industry - including Lloyds' own life affiliates" (Graham, FT, 23 June 1999),¹⁵ the company did not pay any dividends to the group until the 2004 financial year (Bolger, FT, 18 April 2005).

Following the takeovers of C&G, TSB and Scottish Widows, Lloyds' management had to realise that its growth prospects in its domestic market were becoming limited due to concerns expressed by the UK's Competition Commission. In August 1997 Peter Ellwood recognised that Lloyds had reached a size that could run into competition problems if it expanded its UK business further. Ellwood explained that he would still like to grow in the UK through acquisitions, but also conceded that "there has to be a limit to expansion in the UK, simply because of the regulatory forces, so we are exploring other parts of the world" (Graham, FT, 2 August 1997).

The limits to non-organic growth in the UK became obvious when Lloyds approached Abbey National in 2001 and was rebuffed by the Competition Commission on the grounds that Lloyds TSB and Abbey National would have

¹⁴ This comprised a GBP 5.7 billion cash payment and a further GBP 1.3 billion in form of policyholder benefits (*The Banker*, 1 July 1999).

had 27% of all current accounts in the UK. The Competition Commission regards a 25% market share as the limit for market consolidation (The Economist, 14 July 2001). This decision put an end to any further consolidation among the UK's big four clearing banks (Lloyds TSB, Barclays, HSBC and Royal Bank of Scotland). Peter Ellwood, Lloyds TSB's chief executive, explained after the failed deal that acquiring Abbey National had not been a strategic imperative. He said that the bank's future would lie in an overseas deal, preferably a European merger of equals (The Economist, 14 July 2001). Subsequently Lloyds TSB reviewed its options on the international scene¹⁶ and embarked on a long but fruitless search for a European acquisition.

The only significant attempt to grow organically on the European continent was via the bank's online banking operations. Evolvebank, Lloyds TSB's internet bank, was launched in Spain at the beginning of 2001. Management planned to roll it out in Italy, France, and Germany in the following years and aimed to attract 1.4 million customers by 2003 when it was expected to break even (Croft, 2000 FT, 29 November 2000). Jayne Almond, managing director of evolvebank, was quoted as saying "the strategy is to build a pan-European bank but we are doing it one country at a time" (Snoddy, Independent on Sunday, 7 October 2001).

Prior to the launch of evolvebank, Lloyds had pursued a low-profile internet banking strategy in the UK. It kept its internet operation integrated into the main bank and did not introduce a new brand for its online services. Pitman had occasionally downplayed expectations on the use of online banking as a means of reducing distribution costs (Graham, FT, 22 October 1999). Before evolvebank could be launched as a stand-alone unit in the UK, Lloyds TSB established a cooperation with Centrica, a diversified utility company that had moved into financial services. Lloyds and Centrica created an online bank for

¹⁵ The first UK pension mis-selling scandal occurred between 29 April 1988 and 30 June 1994 "when people who would have been financially better off at retirement in their employer's pension scheme were advised to leave or not join their employer's pension scheme" (BBC online, 27 June 2002).

¹⁶ From 2001 several newspapers and news agencies reported over and over again that Lloyds TSB and Deutsche Bank were in merger talks (for example: Nisse, Independent on Sunday, 25 November 2001; The Banker, 1 May 2002; Griffiths, The Independent, 26 November 2001; vwd, 26 November 2001; dpa-AFX, 22 September 2004). Jochen Neynaber told the researcher that there had been talks between Deutsche Bank and Lloyds TSB before Deutsche Bank made its bid for Bankers Trust in 1998. According to Neynaber these talks faltered due to Deutsche Bank's smaller market capitalisation and the implicit junior role it would have had to play (interview Jochen Neynaber, 22 November 2005).

the UK called Goldfish¹⁷ (Croft, 2000 FT, 29 November 2000; Croft & Cameron, FT, 14 December 2000). Evolvebank, for which Lloyds did not disclose the costs, gradually withered away and was effectively dissolved in 2005 when it was announced that it had started to phase out its credit card services and would not accept any new applications (Evolvebank, 2005¹⁸).

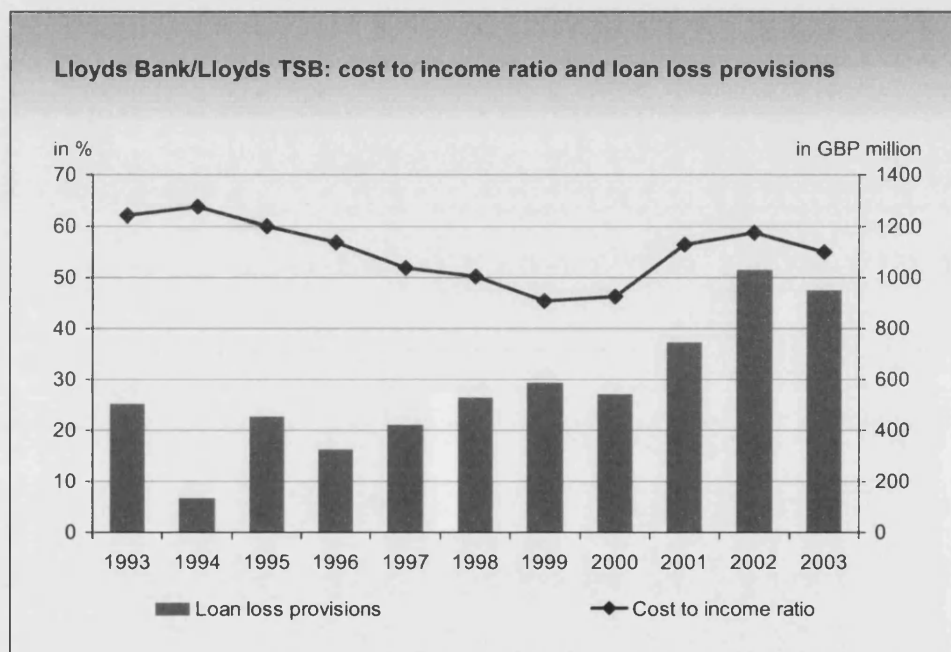
With the closure of evolvebank Lloyds' one and only pan-European retail banking strategy came to an end. According to Neynaber, Lloyds did not have any European ambitions and no European strategy while Pitman was on the board. Neynaber recalled that "Lloyds had set up a team of some 10-12 experts, who exclusively studied all European countries in great detail at an early stage. This team of experts concluded that product differentiation across Europe was so significant that it would be impossible to develop and sell pan-European retail products." An additional important argument "against Europe" was the low profitability of most takeover targets relative to Lloyds' own profitability and the fact that a cross-border deal of this sort offered little prospect of substantial cost synergies that could lift the profitability of these companies (interview Jochen Neynaber). Therefore, the focus remained on the UK and the exposure to the British economy increased over time (Lloyds TSB, Annual Report 2003).

¹⁷ Goldfish was named after Centrica's existing credit card operation (Croft & Cameron, FT, 14 December 2000).

¹⁸ Evolvebank (2005). Evolvebank [online]. London: Evolvebank. Available from: <http://www.evolvebank.com> [Accessed 1 April 2005].

5.8.3. Cost and Risk Management

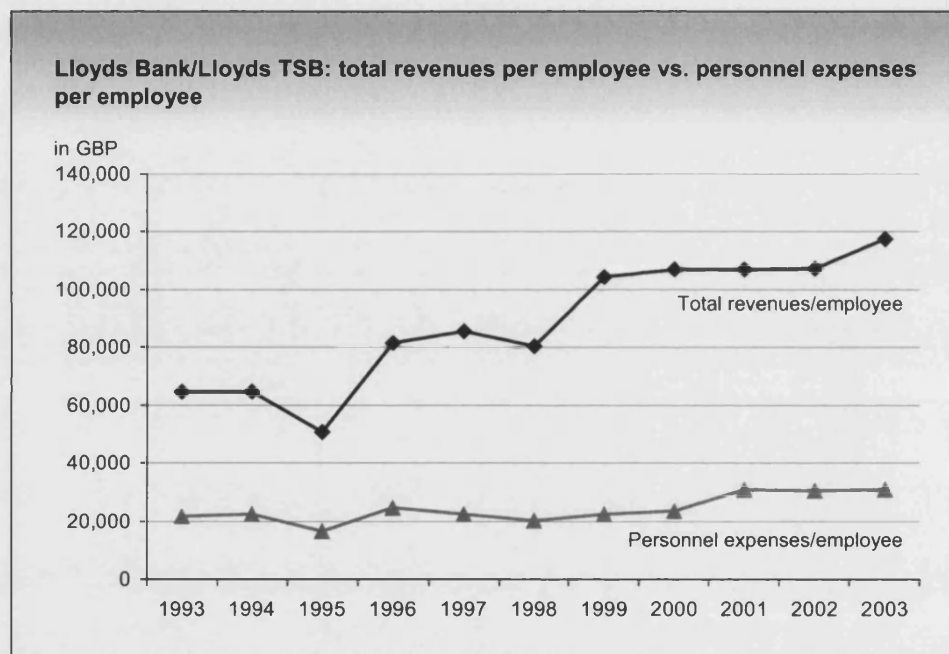
When Lloyds revealed its plan to buy Abbey National in 2001, Ellwood also announced that the group would abandon the cost income ratio target of 35% set the previous year (Willman, FT, 6 February 2001). Under Pitman's leadership the bank was managed according to stringent profitability criteria, which necessitated forceful cost-reduction measures. From 1993 until 2000, the year when Pitman stepped down as chairman, the cost income ratio improved from 62% to 46%. Following Ellwood's statement that the efficiency target would be abandoned, Lloyds's cost income ratio rose to 55% in 2003.



As previously remarked, the cost income ratio is an imperfect indicator of a bank's efficiency as it does not say anything about the group's risk-management skills. The cost income ratio does not include the bank's loan loss provisions. For banks with large loan portfolios and a significant proportion of earnings coming from net interest income, the size of loan loss provisions essentially determines profitability. The relative size and volatility of loan loss provisions reflects the bank's ability to correctly price the risk of its outstanding loans. In the case of Lloyds TSB, risk assessment played a pivotal role in the group's success. The group's loan portfolio increased from GBP 42

billion in 1993 to GBP 137 billion in 2003 with the greatest boost coming in the years 1996/97 due to the acquisitions of C&G and TSB.

Lloyds' improved efficiency can also be illustrated by its 6.1% compound annual growth rate for total revenues per employee compared with a CAGR of 3.5% for total personnel costs per employee. In 1993 Lloyds employed 61,710 staff, which rose on average by 3.1% p.a. to 84,102 in 2003. The average personnel costs per Lloyds' employee in 1993 were GBP 21,717 and rose to GBP 30,463 in 2003.¹⁹ During the same period the bank's revenues per employee nearly doubled from GBP 59,443 to GBP 117,547. The proportion of personnel expenses relative to the bank's total operating expenses before risk provisions declined from 54% in 1993 to 47% in 2003.

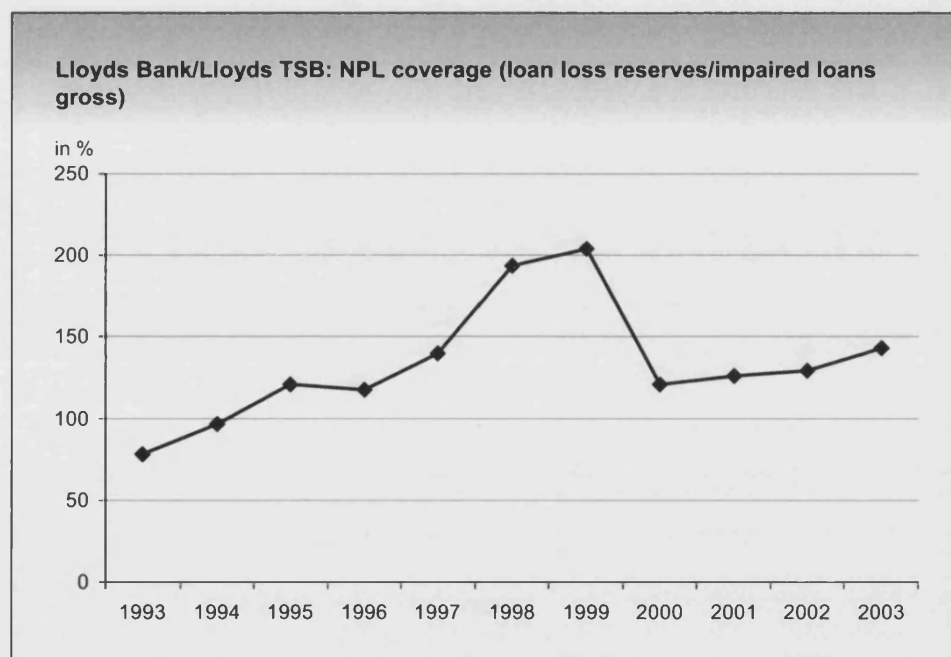


These improved personnel cost ratios resulted from the efficient use of new technologies, economies of scale due to rising revenues, a benign macroeconomic environment in the UK and a pay scheme that emphasised individual performance. In 1993 Lloyds introduced a new pay and performance policy which foresaw no general salary increases but aligned pay completely

¹⁹ When Lloyds TSB adopted the accounting requirements of Financial Reporting Standard 17 (FRS 17) 'Retirement Benefits' in 2001 personnel expenses rose significantly (+35% y-o-y). According to FRS 17 the assets of post-retirement defined benefit schemes have to be included on the balance sheet together with the related liability to make benefit payments. This change of accounting standard led to higher personnel expenses from additional costs for accruing benefits for active employees, benefit improvements and severances. A comparative analysis is therefore of limited use (Lloyds TSB Annual Report, 2002, p. 64).

to performance (Lloyds Bank, Annual Report 1993). Moreover, Lloyds used new technologies to reorganise people around processes. For example, in 1992 it introduced the Service Quality Improvement Programme (SQIP) in order to optimise and streamline the processes at its branches. Lloyds turned towards these re-engineering concepts as a reaction to the growing competition from the more customer-oriented building societies (The Economist, 22 July 1995).

A sophisticated and finely tuned database on the UK housing market (interview Jochen Neynaber) was decisive for risk-adequate pricing of loans and mortgages. The group's top management drove this risk awareness. Pitman argued that profit growth in traditional banking would primarily come from fewer bad debts rather than from more loans (The Economist, 13 June 1992). The rise of the group's coverage ratio (loan loss reserves relative to problem loans) from 78% in 1993 to 204% in 1999 illustrates the quality of Lloyds' loan portfolio. Due to accounting adjustments in 2000/2001 the coverage ratio fell sharply but it still remained well above 100%.



Lloyds' overarching guidance for its cost and risk management originated from an understanding that each business had to at least cover its cost of equity to justify its existence. Pitman introduced this shareholder value-based concept,

which became the mainstream tool for many bank managers in the 1990s, in 1984. Lloyds' management was among the first to conceive this idea and to implement across the bank. An important aspect of such a shareholder value oriented management method was the unambiguity of a single quantitative objective. In numerous articles Pitman explained how in the mid-1980s he and his management team derived "a single definition of success" in order to avoid multiple goals (Gapper & Smith, 1994, FT, 23 April 1994; Bose & Morgan, 1998; Pitman, 2000; Pitman, 2003, HBR).

Pitman explained: "As our performance measure, we would use return on equity, a key indicator of profitability [...] and we decided that we would seek a return on equity of 10% above the prevailing rate of inflation, which at the time was 5%" (Pitman, 2003, HBR, p. 42). Pitman then went on to describe that they (Lloyds' management) realised that the group's return on equity should be measured against the bank's cost of equity. Management calculated that the cost of equity was somewhere between 17% and 19%, reflecting the high interest rate environment in the UK in the late 1980s. Management concluded that every business had to deliver returns on equity that exceeded the cost of equity, which management agreed to be 18%. As interest rates came down during the 1990s the group's cost of equity also fell. It stood at 9% in 1999 and remained there until 2003 (Lloyds TSB Annual Report, 1999, p. 28; Lloyds TSB Annual Report, 2003, p. 27).

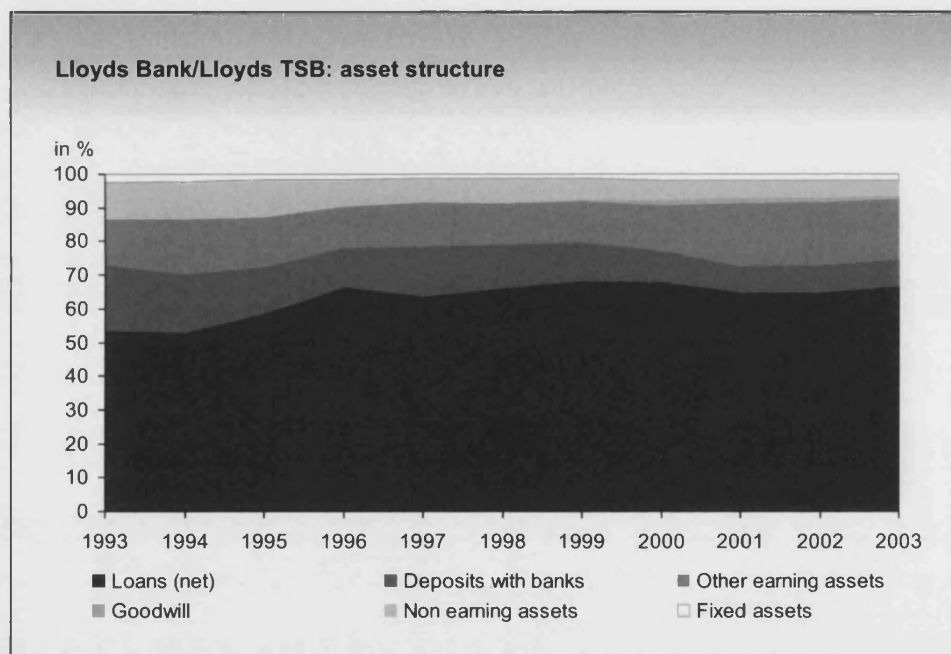
A company's cost of equity also reflects its risk profile and is therefore subject to structural and operational changes. Retail banks are generally understood to have a lower risk profile than investment banks, as their revenues are more stable. However, operational risk may increase if tighter consumer protection rights coincide with profitability requirements and an aggressive sales force. Lloyds TSB's experience with the so-called "precipice bonds"²⁰ is a case in point. The Financial Services Authority fined Lloyds TSB GBP 1.9 million for mis-selling high-income precipice bonds to inexperienced investors between October 2000 and July 2001. The FSA argued that Lloyds exposed its clients to the risk of substantial losses without sufficiently informing them about the product. This resulted in Lloyds having to pay GBP 98 million in compensation

²⁰ "The bonds promised a high income - 10.25% to 9.75% over three years - but the return of investors' capital was linked to the performance of 30 stocks. They are widely known as "precipice" bonds because investors' capital returns "fall off a cliff" if markets fall below a pre-set trigger point" (Burgess & Croft, FT, 26 September 2003).

to 22,500 investors (Burgess & Croft, FT, 26 September 2003).

5.8.4. Asset-Liability Structure

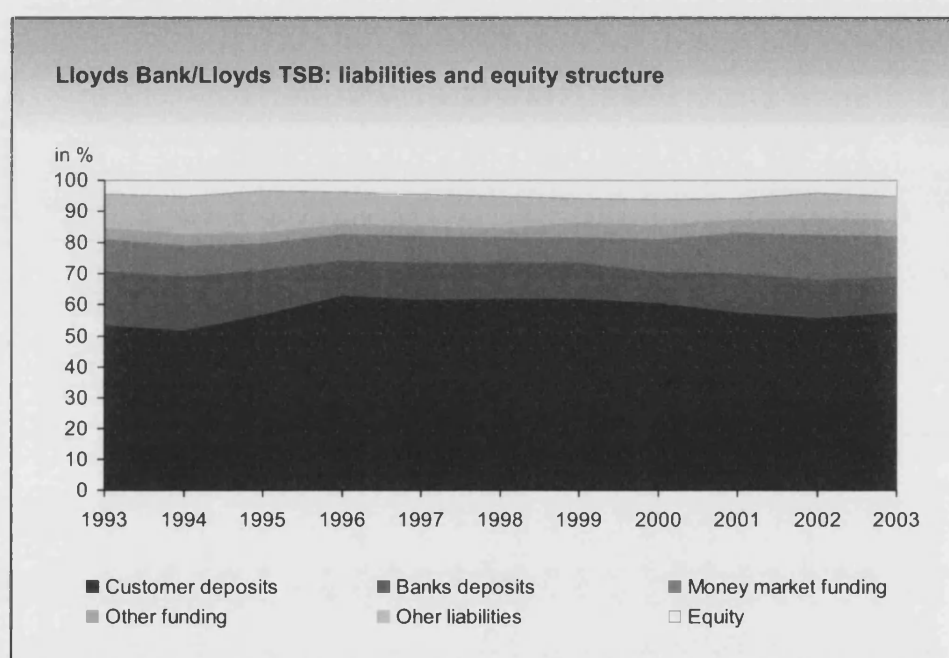
Lloyds' organic growth and the three large UK deals (C&G, TSB, and Scottish Widows) led to an increase in the bank's assets from GBP 72 billion in 1993 to GBP 202 billion in 2003. On average, 63% of the group's assets were tied up in customer loans and some 12% were held as deposits with other banks. Customer loans increased from 58% of total assets in 1993 to 68% in 2003. The largest rise in loans occurred after the acquisition of C&G and the merger with TSB. While 19% of assets were deposits with other banks in 1993, this ratio had declined to 8% in 2003. This development could be explained by the fall in interest rates and more liquid capital markets, e.g. in the form of money market instruments. Furthermore, the higher proportion of loans may also account for this structural shift.



An analysis of Lloyds' liability structure reveals that an average of 59% of its financing came from deposits, mainly from current accounts. Financing from other banks declined over time, while money market instruments gained significance. During the period analysed they represented an average of 10% of the group's refinancing sources. The relatively high proportion of deposits resulted from Lloyds' strong retail client base. Particularly after the C&G and

the TSB deals, deposits increased – from 57% of total liabilities and equity in 1995 to 63% in 1996.

During the period analysed, Lloyds' equity ratio was 4.9% on average, fluctuating quite substantially between 3.4% (1995) and 6.3% (2000). Hybrid and subordinated products rose from 3.4% in 1993 to 5.2% in 2003. The stronger demand for such more differentiated finance instruments may again be explained by the low interest rate environment towards the second half of the period analysed. Moreover, these hybrid products helped it manage the volatility of net profits and therefore stabilise the return on equity.



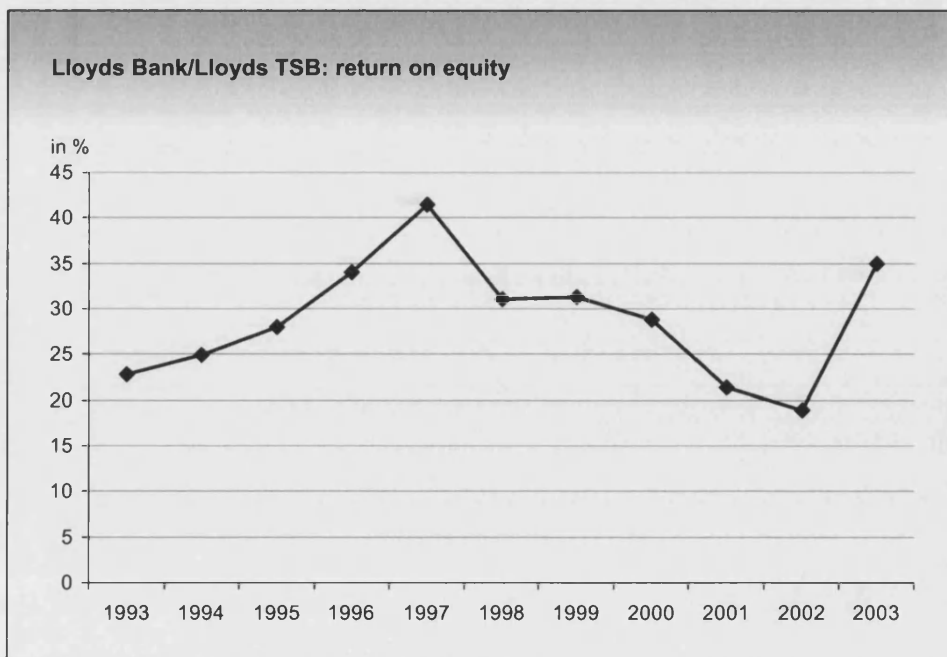
Despite the greater use of hybrid and subordinated bonds Lloyds did not buy back any of its own shares. On various occasions management said it would consider buying back shares provided it did not find suitable takeover targets (Gapper, FT, 7 August 1995; The Economist, 17 January 1998; Linnell, The Banker, 1 January 2000). However, due to the aforementioned acquisitions and in preparation for several deals, which were planned but never realised, the bank did not launch a share buy-back programme during the period analysed. Consequently, its tier 1 ratio was relatively volatile as it fluctuated between a low of 5.8% in 1995 and a peak of 9.9% in 1999. Although Pitman explained in 1995 that he would consider a tier 1 ratio of 6.5% to be adequate

the average figure was 7.9%, leaving the company well capitalised (Gapper, FT, 7 August 1995).

5.8.5. Profitability

When Lloyds' chief executive Brian Pitman decided in the late 1980s to focus on the bank's return on equity as the key measure of profitability, he was one of the first European bank managers to recognise that a bank's balance sheet size cannot be the yardstick for success. The focus on return on equity provided the guiding principle for management to expand or exit a business. Under Pitman return on equity criteria were applied rigorously in decision-making processes. Business units that did not cover the cost of equity and were not likely to achieve the return targets were slashed with Pitman's comment: "let's plough it under" (interview Jochen Neynaber).

Due to a continuous and rigorous review of the group's business activities, cost control and operational focus Lloyds achieved an average net return on equity of 29% between 1993 and 2003. The bank's net profit grew by an average of 17% p.a. while its revenues increased at a compound annual growth rate of 9.5%. In absolute figures, the group's net profit rose from GBP 694 million in 1993 to GBP 3.3 billion in 2003. These extraordinarily high levels of profitability were achieved through the bank's strategic focus on its domestic retail clients, which increasingly emerged as the most profitable business segment, and the readiness to make use of new technologies.



Lloyds' decision to concentrate on the retail market in the UK and to become a driving force for consolidation within the British financial services industry allowed it to benefit from cost-synergies. In addition, an increasingly consolidated market with relatively high barriers to entry kept competition at bay. Pitman described his view of Lloyds as a force for consolidation with the words: "If you do not dictate the competition, someone else will" (Pitman, 2000). Moreover, the UK's economic recovery in the 1990s was particularly beneficial for a bank with such clear geographic focus.

The bank's high profitability and geographic focus led to the strategic dilemma of what to do with its excess capital and where to grow next. Given its average return on equity of 29% most acquisitions within the financial services industry in the 1990s would have diluted the ROE. On the other hand, the ongoing globalisation in the financial services industry, which primarily involved consolidation at national level, made Lloyds appear increasingly vulnerable to political and macroeconomic developments in the UK.

The bank's 2003 annual report noted that Lloyds TSB's earnings were heavily dependent upon its domestic activities as 81% of the group's operating profit was derived from its UK operations. Accordingly, management pointed out that the state of the British economy had significant implications for the way in which Lloyds ran its business and for its performance. Following the disposal of its remaining international operations in New Zealand and Latin America in 2003/04 this would increase substantially (Lloyds TSB, Annual Report 2003). Therefore it may be concluded that Lloyds' domestic profitability posed the major obstacle for the bank's international expansion strategy.

5.8.6. Conclusion

Since the late 1980s and throughout the 1990s Lloyds' corporate strategy was guided by the relatively simple but clear idea that shareholders provide capital in the expectation of earning a return on their investment. Thus, there was no other objective for management than to improve the bank's profitability. Lloyds' strategy during the period analysed was predominantly shaped by the views of Brian Pitman. Under his leadership, the ultimate goal was to maximise the group's return on equity and to compare it with shareholders' opportunity costs, namely the cost of equity. He believed that this could be achieved by focusing on the things the bank could do well and then striving to do them better than anybody else (Lloyds Bank, Annual Report 1993).

With his decision to establish a return on equity target as the single governing objective, he provided an operational framework for the group. When the executive committee set an 18% cost of equity hurdle rate in 1984, it paved the way for the bank to focus on the British market. The 18% cost of equity and the implicit ROE target reflected the high interest rate environment in the UK during the late 1980s. Applying the same return requirements to its foreign operations led to withdrawal from some of these markets.

Management saw the greatest potential for efficiency improvements in the bank's domestic retail and small business market. Scale efficiencies were primarily achieved through acquisitions, thereby shaping the competitive landscape in the UK retail banking market. Innovative risk scoring methods and the advantages of the latest information technology were used to optimise the bank's operations and to enhance efficiency.

The shareholder value principle served to analyse the performance of each line of business from a portfolio perspective and to concentrate on the most profitable ones. Despite the use of portfolio theory, Lloyds' management did not adequately consider the importance of diversification as a source of growth opportunities. With the high levels of profitability achieved by Lloyds, it became increasingly difficult to expand without diluting its existing business. Therefore management concluded that acquisitions on the European continent were not an issue as cost synergies could not be realised and the returns of available players were not promising enough (interview Jochen Neynaber).

The concentration on the UK did not merely create a dependence on a single national economy and its regulatory and legal changes; it also made it difficult for Lloyds to escape from its profitable isolation. The vulnerability to national idiosyncrasies became apparent, for example, with the legal disputes about pension mis-selling and the “precipice bonds”. It remains to be seen whether local knowledge of a bank’s home market outweighs the implicit “cluster risk” of such national strategies in an increasingly interdependent global economy.

5.9. Dresdner Bank AG

5.9.1. Introduction and Status Quo in 1993

Dresdner Bank was established through the conversion of private bank Michael Kaskel¹ into a public limited company and was initially listed on the Berlin stock exchange on 7 January 1873. Eugen Gutmann was instrumental in founding Dresdner Bank and served for 48 years as the bank's first CEO (Ziegler, 2003). During its first decade, Dresdner Bank remained a provincial bank serving the Saxony region of Germany. However, following the opening of a Berlin branch in 1881, and the relocation of its headquarters to Berlin three years later, the bank quickly expanded throughout Germany. It gained market share in the highly fragmented German banking market, partly through organic growth, but also through the acquisition of smaller private banks (Dresdner Bank ed., 1969; Birkefeld, 1997).

Retail banking was a cornerstone of the bank's operations right from the beginning. It provided a relatively attractive source of funding for the bank, which had to satisfy the demand for financing from the growing German industry in the late nineteenth century (Ziegler, 2003). Subsequently Dresdner Bank emerged as the archetypical German universal bank. In 1911, it had 25 branches across Germany and opened another 62 deposit-taking institutions in Berlin and Hamburg in the same year. While Dresdner Bank's retail network appeared moderate compared with the big British clearers, its size was significant by German standards at the time (Dresdner Bank ed., 1969; Birkefeld, 1997; Dresdner Bank, undated).

Dresdner Bank quickly attained international prominence and opened its first overseas branch in London in 1895.² In the following years, it stepped up its international activities and founded the Deutsche Orientbank (German Orient Bank) and Deutsch-Südamerikanische Bank (German South American Bank). Under the auspices of Eugen Gutmann, Dresdner Bank rose from a small provincial bank to one of Germany's leading financial institutions (Ziegler, 2003). Having achieved such an important position also meant that its profitability and therefore stability were of systemic significance for the

¹ Private bank Michael Kaskel was founded in 1771.

German financial sector. Following the German banking crisis in 1931, Dresdner Bank's capital position was so weakened that it had to be bailed out by the state. The German state remained Dresdner Bank's majority shareholder until 1937. According to a group of independent historians, this ownership structure facilitated the institute's close ties with the Naziregime, from which it benefited enormously (Eugen-Gutmann-Gesellschaft, 2006; Henke ed. 2006; Dresdner Bank, undated).³

Although Dresdner Bank emerged again as one of Germany's leading financial institutions after the Second World War, its organisational structure remained highly decentralised until 1971 (Birkefeld, 1997). Like many other banks, both British and German, Dresdner Bank rapidly internationalised throughout the 1970s. In 1973, it re-opened its London subsidiary and was the first western bank to set up an office in Moscow. Following German reunification Dresdner Bank was able to reforge ties to its East German roots. In fact, the bank's heritage provided an additional argument for its eager expansion into the five new states after German reunification in 1990 (Birkefeld, 1997, interviewee⁴). Dresdner Bank was the first West German bank to move into the GDR and by the time of the two countries' monetary union (1 July 1990) it had 35 of branches there and operated another 72 through its joint venture with Deutsche Kreditbank, the East German state bank (FT, 11 April 1990; Birkefeld, 1997).⁵

Launching Dresdner Bank's East German operations was given top priority and handled by management board member Bernhard Walter with close involvement of CEO at the time, Wolfgang Röller. Wolfgang Röller served as

² The London office had to be closed in 1914 at the beginning of the First World War.

³ During the Third Reich Dresdner Bank benefited from its close political ties to the regime and was active in the expropriation of Jews ("Arianisation"). Dresdner Bank's management expected to become the leading bank in a Germanised Europe (Henke ed. 2006). A major study published in 2006 concludes: "Dresdner Bank, which originally had strong Jewish roots, was very close to the National Socialist regime. This was due to the fact that the Bank was 91% state-owned after the 1931 banking crisis and was only reprivatized six years later. The Bank was particularly susceptible to the regime's influence and demands, especially with regard to staffing measures. Dresdner Bank participated in the financing for arms manufacturers. It also had investments in companies that had business links with concentration camps" (Eugen-Gutmann-Gesellschaft, 2006; Henke ed. 2006).

⁴ For this case study around a dozen informal and unstructured interviews were carried out over a period of four years (2002-2006). Important sources were several of the researcher's colleagues, who were former employees of Dresdner Bank. Moreover, shortly after the acquisition of Dresdner Bank, the researcher took over research coverage for Allianz, thus for Dresdner Bank. This gave him the chance of meeting board members and other senior management figures from Dresdner Bank. In addition to these sources, one member of the enlarged senior management team, who was closely involved in Dresdner Bank's corporate strategy during the period analysed, was interviewed in a formal and structured interview. This person asked to remain anonymous and is referred to as "interviewee".

chief executive from 1985 until 1993, when he became chairman of the supervisory board. He was succeeded by the somewhat hapless⁶ Jürgen Sarrazin, who took early retirement in 1997 (The Economist, 20 December 1997).⁷ Thereafter Bernhard Walter became CEO in 1998 and oversaw the bank's fate during the following two years. He stepped down after the planned merger with Deutsche Bank fell through in April 2000. Bernd Fahrholz took over as CEO and remained at the helm until 2003, when retail banking expert Herbert Walter was poached from Deutsche Bank to run the institution.

Besides focusing on its East German business in the early 1990s, Dresdner Bank also wanted to expand its international network.⁸ In 1988, Dresdner Bank had founded Banque pour l'Europe S.A. (Europa Bank AG) in Luxembourg. The purpose of Europa Bank was to target the European single market and to provide support for medium-sized companies. Europa Bank kept a relatively low profile for most of the time and was eventually liquidated in 2003 (Dresdner Bank Annual Report, 2003; Dresdner Bank, undated b). By contrast, the agreement signed in 1989 with Banque Nationale de Paris (BNP) to intensify the two bank's long-standing international cooperation attracted more attention, not least, as it fuelled merger speculation.⁹ This cooperation was primarily aimed at jointly entering the markets of the former communist states in Eastern Europe and was backed by symbolic cross-shareholdings of 0.8% (FT, 11 January 1991; Sen, Metzler Equity Research, 19 January 1999; Süddeutsche Zeitung, 23 December 2000).¹⁰

The cooperation with BNP did not lead to a merger, nor did the countless other rumoured takeover scenarios materialise, but in 1991 Allianz, Germany's largest insurance company, announced that it was increasing its stake in Dresdner Bank. In July 1991 it disclosed that it had raised its holding in Dresdner Bank to 23%, up from around 10-15% at the end of 1990 (FT, 30

⁵ Through the joint venture with Deutsche Kreditbank, Dresdner Bank had 340,000 private customers, some 13,000 commercial customers and 3,500 employees in East Germany (FT, 30 November 1990; Birkefeld, 1997).

⁶ During Sarrazin's time, Dresdner Bank had to deal with an investigation into smuggling depositors' money to tax-free accounts in Luxembourg (The Economist, 20 December 1997). Departing from German corporate governance tradition, Sarrazin was not even offered a seat on the bank's supervisory board when he left the management board.

⁷ In 1997, Wolfgang Röller handed over the position as chairman of the supervisory board to Alfons Titzrath, a former member of Dresdner Bank's management board. Alfons Titzrath was succeeded by Henning Schulte-Noelle, CEO of Allianz, in 2001. When Michael Diekmann became Allianz' new chief executive in 2003 he also began chairing Dresdner Bank's supervisory board.

⁸ In 1990, Dresdner Bank opened representative offices in Warsaw, Prague and Budapest.

⁹ The cooperation ended in 2002 (Dresdner Bank, undated b).

July 1991). This increased stake underpinned the distribution agreement that Dresdner Bank had concluded with Allianz in 1989 to sell insurance products through its retail network. Ten years later, in July 2001, Munich-based Allianz took over Dresdner Bank, which was headquartered in Frankfurt. Dresdner Bank was delisted from the stock market on 7 November 2002, precisely 129 years and 10 months after it went public. The following case study will analyse the bank's strategic odyssey during the last decade of its independence and the first years under the ownership of Allianz.¹¹

¹⁰ When Dresdner Bank established a subsidiary in St. Petersburg in 1993 in conjunction with BNP, it became the first foreign bank in Russia with a full banking licence (Dresdner Bank, undated b).

¹¹ CEO Sarrazin said in October 1997 that there were no plans to intensify the cross-ownership between Dresdner Bank and Allianz (Süddeutsche Zeitung, 31 October 1997). Some four months later his successor Walter said, "From today's standpoint, this topic is not on our agenda," thus not categorically ruling it out (Fisher, FT, 2 February 1998).

5.9.2. Income Structure

5.9.2.1. Structural Overview

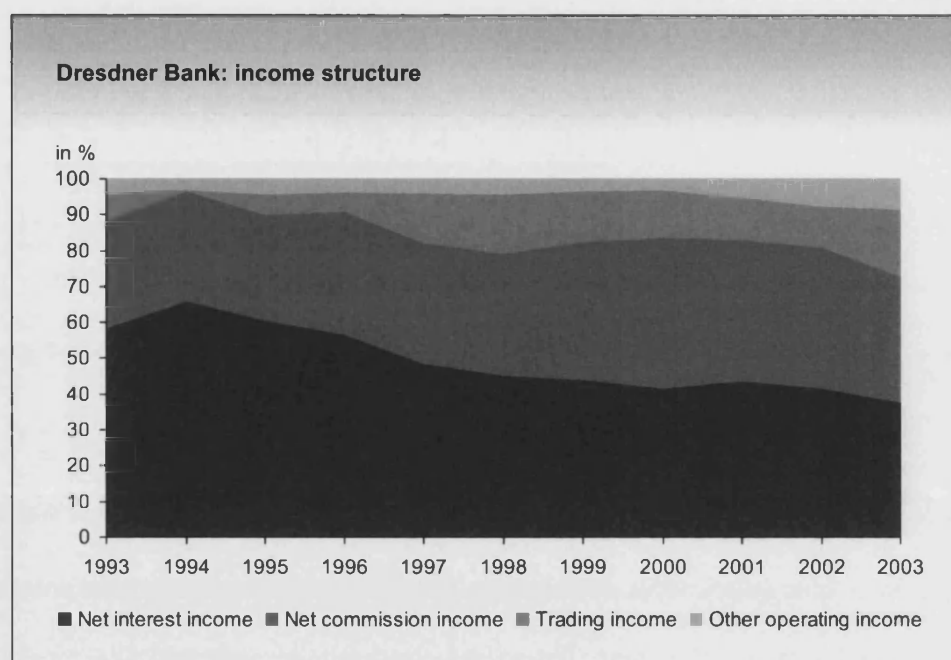
In 1993 Dresdner Bank generated 72% of its total operating income in Germany and 23% in other European countries (Dresdner Bank, Annual Report 1993, p. 5). At the time, it employed 93% of its 42,017 staff in its domestic market. Apart from the acquisition of UK merchant bank Kleinwort Benson (1995) and the M&A boutique Wasserstein Perella of the US (2000), Dresdner Bank predominantly continued its organic internationalisation throughout the 1990s and opened offices in such “global financial hubs” as Antananarivo (Madagascar), Oshakati (Namibia) and Yekaterinburg (Russia) (Dresdner Bank, Annual Report 1997).¹² By 2003, the proportion of income from Germany was down to 54% and the bank received 34% of its revenues from the rest of Europe (Dresdner Bank, Annual Report 2003).

Besides internationalisation, Dresdner Bank pursued an expansive strategy in Eastern Germany, after reunification. Given the bank’s roots in the Eastern German city of Dresden, management felt that the bank was obliged “to make a decisive commitment at an early stage to the new Federal States. From this basic conviction the bank developed an expansion strategy [...]” (Dresdner Bank, Annual Report 1994, p. 18). In 1993, three years after German reunification, Dresdner Bank’s CEO remarked that “the task of rebuilding eastern Germany requires a volume of resources [...] [which] means accepting restraint for a number of years” (Dresdner Bank, Annual Report 1993, p. 5).¹³

In 1993, Dresdner Bank’s universal banking model resulted in an income structure, which was still largely dominated by net interest income. 59% of the bank’s revenues were net interest income, whereas 30% came from commission income. With the acquisition of Kleinwort Benson in 1995, commission income gained significance and rose by 5 percentage points in 1996. Management explained in the 1998 Annual Report that it aimed to

¹² Despite the word “focus”, the following quote exemplifies management’s lack of it: “Dresdner Bank’s international strategy is focussed upon developing its business in central and eastern Europe, the high growth regions of Asia and the NAFTA zone in North America; this is in addition to expanding the Bank’s global presence in investment banking [...]” (Annual Report 1994, p. 18). Four years later, at the advent of the single European currency zone Dresdner Bank’s management explained that it regarded Euroland as its domestic market (Dresdner Bank, Annual Report 1998, p. 21).

further expand its commission income relative to its interest income through more advisory work (Dresdner Bank, Annual Report 1998, p. 21).

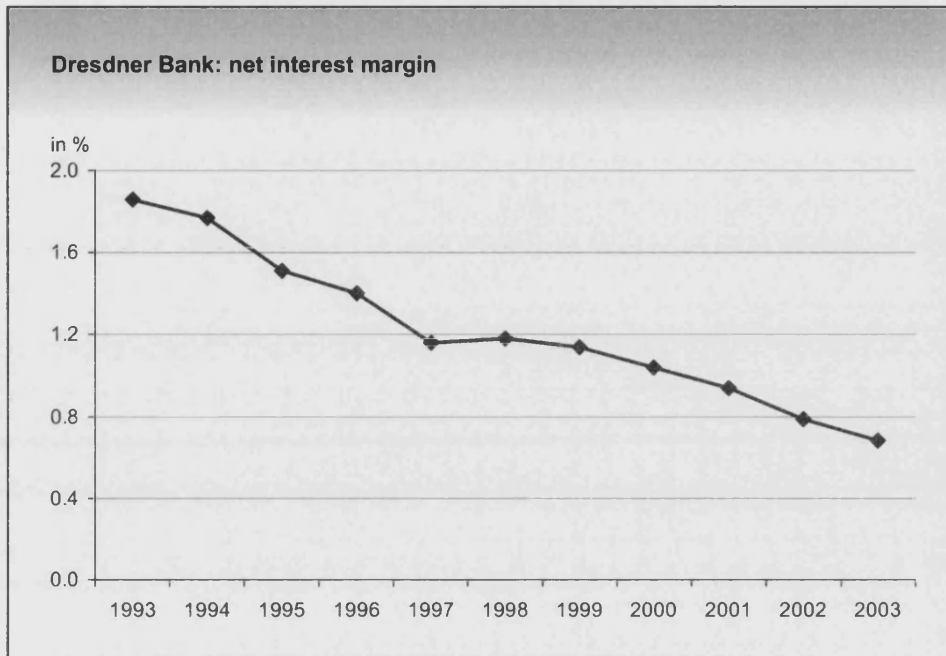


Indeed, Dresdner Bank's transaction services increased to such an extent that in 2000 42% of total operating income originated from commission income, thereby equalling net interest income. In absolute figures, this meant net interest income and commission income each amounted to EUR 4.3 billion. During the period analysed, commission income grew at a compound annual growth rate of 4.8% and accounted on average for some 35% of group's total operating income.

While the proportion of net interest income declined continuously, this source of income still made up 50% of the group's total operating income between 1993 and 2003. Over the entire period analysed, Dresdner Bank's net interest income fell by an average of 1.2% p.a. (CAGR) as interest expenses rose faster than interest income, eroding the net interest margin. Dresdner Bank expanded its loan portfolio up to 2001, when it totalled EUR 240 billion, compared to EUR 111 billion in 1993. The bank grew its loan portfolio into

¹³ The book with the telling title "With full steam ahead into the unknown" ("Mit voller Kraft ins Ungewisse" Birkefeld, 1997) recounts Dresdner Bank's early expansion phase into East Germany and concludes that it vastly built personnel overcapacity, and misjudged the development of the real estate market.

declining profitability during that time as net interest margin fell from 1.86% (1993) to 0.94% (2001) and decreased further to a mere 0.68% in 2003.



Since commission income rose and interest income fell, these two earning components were relatively balanced by 2003. At the end of the period analysed, Dresdner Bank's net interest income contributed 38% to the group's operating income while commission income contributed 35%. Over time, the share of trading income also gained importance. In 2003, trading contributed 19% of the group's total operating income. This high proportion of trading income resulted from an average annual growth rate of 13%, due to management's decision to step up its investment banking operations.

The strong rise in trading income and the moderate growth of commission income were able to make up for the fall of net interest income so that the bank's total operating income nevertheless showed a positive trend with a 3.2% CAGR for the whole period. Between 1993 and 2003 Dresdner Bank's total operating income rose from EUR 5.4 billion to EUR 7.4 billion. The year 2000 was the best year ever for Dresdner Bank in terms of revenues, with total operating income reaching EUR 10.2 billion.

So far, this structural review has considered only sources of operating income. However, for Dresdner Bank to deliver the levels of profitability it did, the group's non-operating income was decisive. Dresdner Bank boosted its income by an average of EUR 775 million p.a. through non-operating income, which more than offset the EUR 442 million p.a. in non-operating expenses that were booked between 1993 and 2003. Therefore, the positive net effect was on average EUR 334 million, lifting the group's pre-tax ROE by 3.1 percentage points.

The group's non-operating income resulted from the continuous sale of its large shareholdings in non-banks. Dresdner Bank held shares, directly or indirectly, in several German companies (non-banks). These insurance and industrial stakes were valued EUR 7.7 billion at the end of 1994 (Dresdner Bank, Annual Report 1994). The value of these non-bank shareholdings rose in the following years and stood at EUR 17.6 billion at year-end 2000. However, Dresdner Bank's policy of divesting its interests¹⁴ in the non-bank sector and the falling equity markets reduced the value of the group's shareholdings to EUR 4.6 at the end of 2003 (Dresdner Bank, Annual Reports 1994, 2000 & 2003).

The build-up of these industrial holdings has its roots in the structure of the German economy in the late nineteenth century when German banks were effectively the forerunners of today's private equity investors. Through shareholdings in the companies they lent to, banks tried to overcome information asymmetry and the "principal-agent problem" between lender and owner. This ownership structure prevailed and was instrumental in the reconstruction of Germany's economy after the Second World War. It constituted the hub of the bank-client relationship in the post-war period, continuing until the 1990s. Dresdner Bank's attempt to break out of this established structure and transform its business model into one that could combine an Anglo-Saxon investment banking style with its traditional commercial banking approach is the subject of the following section.

¹⁴ For example, in 2000, Dresdner Bank realised EUR 2.3 billion from the sale of its corporate holdings (Dresdner Bank, Annual Report 2000 p. 18).

5.9.2.2. Corporate and Investment Banking

Dresdner Bank's corporate banking activities in the early 1990s were dominated by its efforts to gain market share through lending to companies in Eastern Germany. Three years after German reunification, Dresdner Bank's management explained that it arranged "for an increasing number of customers to obtain loans available under government assistance programmes for the funding of investment projects" in East Germany (Dresdner Bank, Annual Report 1993, p. 18). By 1994, it was lending to 33,000 companies in Eastern Germany – at a time when the number of corporate customers amounted to 200,000 (Dresdner Bank, Annual Report 1994). Besides historical reasons for wanting to have a strong position in Eastern Germany, Dresdner Bank also regarded itself as the bank for small and medium sized companies, the German Mittelstand.¹⁵

Of its German corporate client base, 95% were small and medium-sized firms. While these companies form the backbone of the German economy, they are also most vulnerable to weak economic growth. In 1994, Dresdner Bank's management pointed out that the past recession¹⁶ in fact vindicated "the house bank principle", as the bank was better placed to resolve the problems of its long-term clients because of the established relationship (Dresdner Bank, Annual Report 1994). However, this house bank principle seemed to be less suited for gaining new clients and growing revenues. In 1998, Dresdner Bank still referred to 200,000 corporate and institutional customers, of which 145,000 were German clients. The number of clients fell to 175,000 in 1999 and 160,000 in the following year (Dresdner Bank, Annual Reports, 1994, 1999, 2000).

As shown in the previous section, Dresdner Bank's net interest margin more than halved in the period analysed. Notwithstanding the bank's declining margins, Joachim von Harbou, the member of the management board responsible for corporate clients, explained in 2000 that the bank would not withdraw from lending to small companies. He argued that over the past ten years, Dresdner Bank's lending to smaller and medium-sized companies had grown by a compound annual growth rate of 10% (Dresdner Bank, Annual

¹⁵ These two factors probably explain best why Dresdner Bank pursued such an expansive lending policy in Eastern Germany.

¹⁶ Real GDP declined by 1.1% y-o-y in 1993.

Report 2000).¹⁷ Contrasting this growth rate with the 1.8% German GDP growth during the same time should have alerted management to the poor quality of the loan portfolio, given that their market share did not rise.

After its expansive lending spree in Eastern Germany, Dresdner Bank began internationalising corporate and investment banking in 1994 (Dresdner Bank, Annual Report 1994, pp. 25-31). It had already realigned its investment banking activities in 1992 and tried to sharpen its profile in the following years. Despite such measures as the launch of a securities research unit, Dresdner International Research Institute (DIRI), the bank's capital markets expertise remained rudimentary compared to Anglo-American and Japanese securities institutions. It also employed just some 160 members of staff in London in 1994 (Waller, FT, 14 March 1994; *Süddeutsche Zeitung*, 16 June 1995).¹⁸ Management was determined to move into international investment banking and follow its rival Deutsche Bank, which had bought the British investment bank Morgan Grenfell in 1989.

Eventually, Dresdner Bank successfully bid for UK merchant bank Kleinwort Benson in June 1995, for which it paid GBP 1 billion (*Börsen-Zeitung*, 27 June 1995). Kleinwort Benson operated an asset management business, enjoyed a good reputation as a corporate finance house, advising on mergers and acquisitions and was strong in equities brokerage. It delivered a pre-tax profit of GBP 97 million in 1994, which implied a ROE of 20%. Kleinwort Benson added a workforce of 2,900 and strengthened Dresdner Bank's international position in investment banking through offices in Paris, New York, Tokyo and Hong Kong (*Süddeutsche Zeitung*, 16 June 1995). Dresdner Bank's CEO Sarrazin said Kleinwort Benson would be run on a long lead, but he conceded that the overarching strategy would be determined in Frankfurt (Fisher, FT, 10 August 1995).¹⁹ The decision to keep control over investment banking in Frankfurt remained an ongoing issue and led, for example, to the departure of Simon Robertson, chairman of Kleinwort Benson, in 1997 (*Süddeutsche Zeitung*, 3 March 1997).²⁰

¹⁷ In 2000, 55% of Dresdner Bank's corporate clients had less than DM 1 million of revenues (Dresdner Bank, Annual Report 2000).

¹⁸ This move followed Deutsche Bank's establishment of DB Research in 1992 (Waller, FT, 14 March 1994).

¹⁹ This decision differed from Deutsche Bank's approach: Deutsche Bank handed over all investment banking power to its London subsidiary Morgan Grenfell.

Following the acquisition of Kleinwort Benson, Dresdner Bank merged its commercial and investment banking products in 1996 to offer its clients a “universal banking” approach (Dresdner Bank, Annual Report 1996, p. 32). The bank’s management in Frankfurt am Main regarded investment banking primarily as a product group. This meant Dresdner Bank’s traditional lending-oriented commercial bankers had to market British transaction services to an international clientele (Dresdner Bank, Annual Report 1998; interviewee). Combining traditional commercial banking services with transaction services created managerial challenges regarding the different risk perceptions of these two types of bank, different approach taken by investment and commercial bankers vis-à-vis clients, and rivalry over compensation.

Moreover, the milestone acquisition of Kleinwort Benson inspired Dresdner Bank to become even more international²⁰ and to grow its investment banking operations in the USA. Dresdner Bank’s CEO Sarrazin stressed the bank’s determination to expand its global investment banking activities. He said with regard to investment banking, “We don’t want to be niche players. [...] We want to play with the big players worldwide” (Peterson, *Business Week*, 10 November 1997). This view was shared by his successor Walter, who also wanted Dresdner Bank to be a global player in investment banking, and therefore saw the need to have a greater presence in the USA and Asia (Fisher, *FT*, 2 February 1998; Dresdner Bank, Annual Report 1998, p. 21).

Consequently, it did not come as a complete surprise when Dresdner Bank announced the USD 1.4 billion acquisition of US investment bank Wasserstein Perella in 2000. Wasserstein Perella enjoyed a good reputation as US M&A boutique, co-founded and managed by Wall Street “legend” Bruce Wasserstein, who defected in November 2001 to run Franco-American investment bank Lazard Frères. Just as the takeover of Kleinwort Benson seemed like a belated emulation of Deutsche Bank’s 1989 purchase of Morgan Grenfell in London, the 2000 Wasserstein Perella deal seemed to mimic Deutsche Bank’s Bankers Trust acquisition of 1999 (Major, Saigol & Silverman, *FT*, 13 September 2000; *Süddeutsche Zeitung*, 2 March 2002). The acquisition of Wasserstein Perella was also symbolic. It fulfilled the

²⁰ Robertson had been with Kleinwort Benson since 1963 and was considered one of the most senior investment banking figures in the City of London (*Süddeutsche Zeitung*, 3 March 1997).

²¹ In 1998 Dresdner Bank acquired 67% of Albertini & C, the Italian equity and bonds broker, and took over the remaining stake in 2001.

purpose of rebuilding morale among Dresdner Bank's investment bankers, who needed reassurance about the future of investment banking at Dresdner Bank after the failed merger with Deutsche Bank in April of the same year (interviewee).

In summer 2000, after the failed merger with Deutsche Bank, which will be analysed in the section on cost and risk management, Dresdner Bank's management set out its plans to become a "focused European advisory bank" (Willman, FT, 22 May 2000). This revised strategy acknowledged that it was not and probably would not be an international investment bank. Moreover, management conceded at the time, that it should scale back its international commercial loans. This was expected to release up to EUR 1 billion of core capital by 2003 (Willman, FT, 22 May 2000).

CEO Fahrholz confirmed that there was indeed a general policy of linking lending to the sale of investment banking services. He was quoted as saying, "We shouldn't stretch our capital to lend to companies unless they are buying our investment banking products" (Willman, FT, 22 May 2000). Finally, a new division, Corporates & Markets, was devised to merge Dresdner Bank's investment banking and corporate customers' activities. This suggests that the previous idea of selling investment banking products and capital markets solutions through Dresdner Bank's traditional commercial bankers did not work well.

Following the takeover of Dresdner Bank by Allianz in July 2001, the new owners turned their attention to the bank's corporate and investment banking activities. Against the background of the accelerating downturn on the equity markets and heightened economic and political uncertainty, the real costs and risks of Dresdner Bank's investment banking strategy and lending policy over the past years became evident. When Allianz realised the consequences of Dresdner Bank's policy, the focus was on limiting the financial damage from write-downs, falling revenues and volatile trading results.²²

During the following two years, Allianz was primarily concerned with scaling back risks and costs at its new banking segment. In order to stabilize and

reposition the bank, the institutional restructuring unit (IRU) was set up and the headcount was cut by some 15,000 between 2001 and 2004. These measures will be discussed in the sections on cost and risk management and asset-liability management. In 2002 Fahrholz, CEO of Dresdner Bank who was also responsible for the Corporates & Markets division, said "We cannot be satisfied with this result and we will make every effort to return to profitability in 2003" (Dresdner Bank, Annual Report, p. 20). In 2003, the corporate and investment banking divisions together did deliver a pre-tax profit of EUR 651 million. However, this achievement resulted only from realigned segmental reporting, whereby Dresdner Bank set up two new divisions in which it booked a total pre-tax loss of EUR 2.4 billion.²³

²² Seen through the eyes of an equity analyst who followed Allianz at the time, all these measures at Dresdner Bank resembled an emergency operation rather than running one of Germany's largest banks with nearly EUR 250 billion of outstanding loans (2001).

²³ EUR 1.3 billion before taxes were booked to the Institutional Restructuring Unit and EUR 1.1 billion was allocated to the Corporate Investments segment (Dresdner Bank, Annual Report 2002, p. 109; Dresdner Bank, Annual Report 2003, p. 11).

5.9.2.3. Asset Management

One important reason for the acquisition of Dresdner Bank was the view held by Allianz management that scale efficiencies provide a major competitive advantage in the fund management industry. In 2000, Dresdner Bank had EUR 272 billion of assets under management, while Allianz managed EUR 750 billion. Shortly after the takeover, Allianz merged the two institutions' fund management arms. Subsequently it managed more than EUR 1,000 billion of assets and, measured by total assets under management, ranked among the five largest asset managers in the world. The new corporate division Allianz Dresdner Asset Management (ADAM) was in charge of developing, producing (i.e. portfolio management) and providing sales support on a global basis.²⁴ However, sales and customer management were organised locally (Allianz, 31 March 2001; Allianz, 3 April 2001).

Besides sheer size, Allianz management argued that joining forces with Dresdner Bank would make it a bancassurance firm with a "unique position in the attractive long-term savings market in Germany" through an improved distribution network in the retail market for mutual funds and equities (Allianz, 31 March 2001; Allianz, 3 April 2001). In fact, Dresdner Bank and Germany's largest insurer had already intensified their corporation in the fields of asset management and personal savings in 1997 and ADAM had existed since 1998 as an IT operation, although it did not gain prominence before the takeover (Süddeutsche Zeitung, 30 July 1997; Dresdner Bank, Annual Report 1998). Allianz considered combining its insurance skills with the capital market and asset management expertise of Dresdner Bank as particularly conducive to gaining market share in the growing corporate pension fund market. Obviously, Dresdner Bank's corporate client base was also a point of contact for cross-selling insurance and corporate pension products (Janssen, Metzler Equity Research, 5 March 2004).

For the German retail fund market, Allianz kept Dresdner Bank's asset management arm, Dresdner Investment Trust (dit). At the time of the takeover, dit ranked fourth among German investment companies, with a market share of 14% (Allianz, 31 March 2001). Dresdner Bank had achieved this position in asset management through a combination of organic growth and acquisitions.

²⁴ Joachim Faber was appointed member of the board of Allianz responsible for the group's asset management business.

At the beginning of the period analysed, Dresdner Bank had assets under management of some DM 85 billion (EUR 43 billion). Through the takeover of Kleinwort Benson in summer 1995 it increased this by GBP 14 billion²⁵ (Cohen, FT, 14 June 1995) and gained a foothold in the Anglo-Saxon fund management community. In the same year, Dresdner Bank also bought the US asset management group RCM for USD 300 million. Headquartered in San Francisco, RCM managed US and international securities with a focus on equities. Its total assets under management amounted to USD 27 billion in 1995. RCM had also a notable track-record in managing corporate pension funds – an area in which Dresdner Bank's German asset management division could benefit from the experience of their US colleagues (Fisher, FT, 30 November 1995; *Süddeutsche Zeitung*, 16 December 1995).

Despite the expansion into the USA, which gave Dresdner Bank greater international acceptance, management said it wanted to keep the focus on Europe where it expected 15% annual growth in the coming years (*Süddeutsche Zeitung*, 16 December 1995; Fisher, FT, 18 December 1995). The takeover of Kleinwort Benson and RCM greatly increased Dresdner Bank's international profile in fund management.²⁶ Following these two sizeable acquisitions, the bank's asset management operations were recognised as a separate strategic business division within Dresdner Bank group and gained momentum (Dresdner Bank, Annual Report 1996, pp. 38-39). Total assets under management rose to DM 250 billion in 1995 and DM 330 billion a year later (*Süddeutsche Zeitung*, 16 December 1995; Dresdner Bank, Annual Report 1996).

As of 1998, Dresdner Bank began using an increasing number of different distribution channels, such as the internet and call centres for its retail funds (Dresdner Bank, Annual Report 1998). For most of the period analysed, the structure of assets under management remained relatively well balanced. Equities and fixed income each fluctuated between 40 and 50% with the remainder being invested in property and money market instruments (Sen, Metzler Equity Research, 19 January 1999). Following the acquisition of Dresdner Bank, its asset management operations were combined with those of Allianz at an early stage of the integration process. Subsequently, Dresdner

²⁵ Kleinwort Benson managed a further GBP 13.5 billion of assets through fund management joint ventures.

Bank's asset management activities became part of Allianz Dresdner Asset Management, a separate division within the Allianz group, and were therefore reported in Allianz annual report as of 2001 – effectively this meant the end for Dresdner Bank's asset management activities.

²⁶ In 1998, Dresdner Bank's asset management arm initiated a joint venture with Japanese life insurance company Meiji Life that helped the company to position itself in the Japanese pension fund market.

5.9.2.4. Retail Banking

Retail banking at Dresdner Bank in the early 1990s was marked by expansion into Eastern Germany. Within five years after reunification, 245 branches had been opened across the new federal states (Birkefeld, 1997).²⁷ The cost of setting up the new branches in Eastern Germany were substantial. Each new branch cost around DM 1 million and the cost of interim premises (mobile units) used before a bricks-and-mortar branch could be opened, amounted to DM 500,000 each (Birkefeld, 1997). Besides these initial investments, Dresdner Bank's expansion into Eastern Germany had also repercussions for its asset-liability structure. Until the end of 1993, loans and deposits from East German retail clients rose proportionally.²⁸ However, in the following years deposits stagnated while the demand for loans continued to rise, putting a strain on funding Dresdner Bank's East German undertakings (Birkefeld, 1997, p. 93).

In 1994, Dresdner Bank reviewed its organisational structure and introduced a Private Customers/Private Investors Advisory business division (Dresdner Bank, Annual Report 1994). Along with the new structure, management proclaimed the mediocre strategic goal of improving "the quality of services for the benefit of Dresdner Bank customers" (Annual Report 1994, p. 20). CEO Walter reiterated similar self-evident "strategic wisdom" when pointing out in 1998 that client orientation and new services were the bank's two strategic targets (*Süddeutsche Zeitung*, 27 March 1998; Dresdner Bank, Annual Report 1997, p. 27). Despite such vague views about retail banking and strategic ignorance, Dresdner Bank expanded its branch network. In 1995, the peak was reached with 1,629 branches worldwide (Dresdner Bank, Annual Report 1995).

In an effort to differentiate its distribution channels, Dresdner Bank considered stepping up its online banking activities and private banking services (*Süddeutsche Zeitung*, 2 November 1996). In 1997 it bought Hardy & Co. Privatbankiers, which then formed the core of the German private banking operations (Dresdner Bank, Annual Report 1997, p. 28). In the same year Dresdner Bank opened private banking centres in Geneva, London, Miami, and Singapore, thereby implementing its internationalisation strategy, which

²⁷ In 1992, Dresdner Bank had 4.9 million retail clients of whom 1.5 million lived in Eastern Germany (Dresdner Bank, Annual Report 1992).

dated back to 1993 (Annual Report 1994, p. 20; Dresdner Bank, Annual Report 1997, p. 28).²⁹

Dresdner Bank broadened its multi-channel distribution approach, through the acquisition of Advance Bank from Bayerische Vereinsbank in 1997.³⁰ This one-year old advisory-oriented direct bank had 40,000 clients at the time of the takeover and increased its customer base to 100,000 in 1998 (Dresdner Bank, Annual Report 1998).³¹ Although Advance Bank targeted prosperous young people and successfully grew the number of clients in the following years, it remained unprofitable and was fully integrated into Dresdner Bank in 2002 (Dresdner Bank, Annual Report 2002).

Introducing online banking services brought new momentum to cost-cutting at Dresdner Bank's branches. In 1998, Dresdner Bank operated the largest domestic retail network in the German banking sector with a total of 1,464 branches (Sen, Metzler Equity Research, 19 January 1999). CEO Walter announced that 800 jobs would be cut in high street branches in 1998, following on from the previous headcount reduction of 4,500 since 1993 (FAZ, 27 March 1998). Moreover, in 1999, 53 branches were closed down in Germany and in the following year, it was announced that Dresdner Bank would close down another 300 of its German retail banking branches, bringing the total down to 850 by the year-end 2003 (Willman, FT, 22 May 2000).

As of 2000, Dresdner Bank's retail banking distinguished between customers who required little advice and high-net-worth private clients who were interested in sophisticated investment banking and asset management products. In 2000, over 50% of total income of the private clients division came from commission income in the securities business. At the time management said it expected a further positive development of the securities business with retail clients in Germany. Yet, precisely the opposite happened and in the following year, revenues were substantially down "mainly due to lower commission income from domestic securities business with private clients" (Dresdner Bank, Annual Report 2001, p. 55).

²⁸ Around DM 3.4 billion loans versus DM 7 billion deposits (Birkefeld, 1997, p. 93).

²⁹ By 1999, it served 550,000 high-net-worth private customers in Germany and 65,000 international private banking clients. This compares to around 5.9 million high-street banking clients (Dresdner Bank, Annual Report 1999).

³⁰ The deal was closed on 1 January 1998.

Allianz made its bid for Dresdner Bank in spring 2001, just as the stock markets started to crash. The deal was closed in July of the same year. At the time of the takeover, the main German equity index, DAX, stood still at around 5,800 points, but declined to 5,100 at the end of the year and continued to fall, dropping to 2,200 in March 2003. It was against the background of this capital market trend and weak macroeconomic environment that the integration of Dresdner Bank into Allianz began.

In the presentation held by Allianz' management to convince investors of the takeover, retail banking was core. It was argued that the acquisition of Dresdner Bank would allow Allianz to secure control of a distribution channel that was key to effectively penetrating the German market for mutual funds and equities (Allianz, 3 April 2001). This reasoning is not very persuasive, given Dresdner Bank's moderate domestic market share of approximately 5% in retail banking and the fact that a distribution agreement between the two companies had existed since the early 1990s (Fitch Ratings, Dresdner Bank, 25 October 2004). Moreover, Allianz operated a distribution network with 11,900 full-time insurance agents in 2001. Self-employed tied agents are compensated on a variable commission basis, while bank clerks earn a fixed salary.

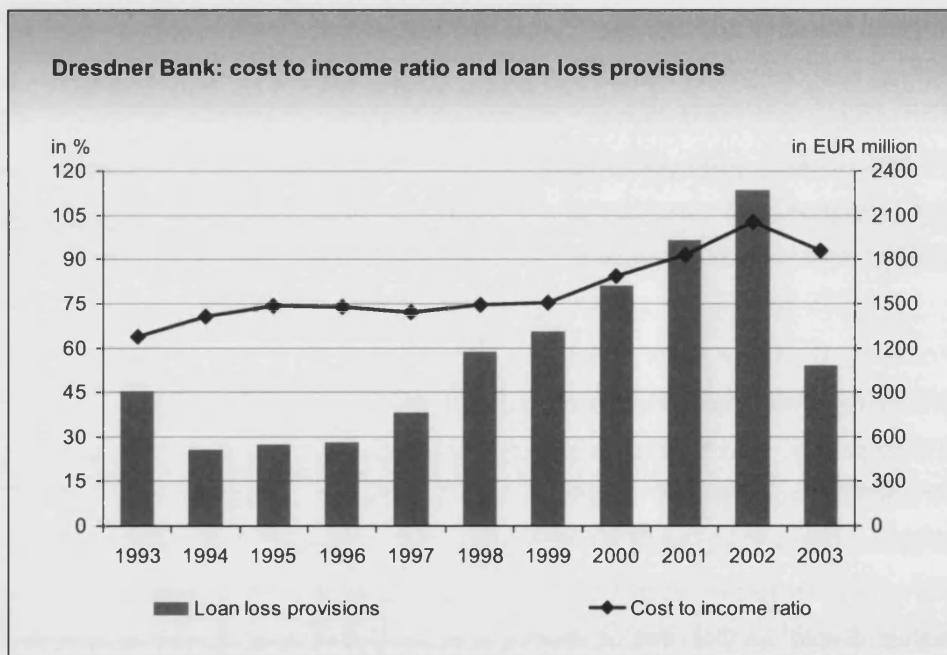
Following Dresdner Bank's takeover, "the renaissance of financial advice" was proclaimed as the new credo (Dresdner Bank, Annual Report 2001). Subsequently, 960 Allianz employees were deployed in bank branches as "financial planning and insurance representatives" whereas only 160 of Dresdner Bank's securities advisors joined Allianz agencies in 2002 (Dresdner Bank, Annual Report 2002). Management highlighted that individual financial advice would be the key to banking in the future and appointed Herbert Walter, a retail banking expert from Deutsche Bank, as Dresdner Bank's new CEO at the beginning of 2003. Under Walter the Private and Business Clients division, established in 2001, focused on the broad mass of retail customers, while further reining in costs and cutting back the number of branches (Dresdner Bank, Annual Report 2003).³²

³¹ In 1999, the number of Advance Bank clients climbed to 151,000 and rose further to 210,000 in the following year (Dresdner Bank, Annual Reports, 1999 & 2000).

³² At the end of 2005, the total number of Dresdner Bank branches worldwide was 959, compared to its peak of 1,629 in 1995 (Dresdner Bank, Annual Reports 1995 & 2005).

5.9.3. Cost and Risk Management

Between 1993 and 2003, an average of 32% of Dresdner Bank's net interest income was eaten up by loan loss provisions, which amounted to around 15% of each year's total operating expenses. Moreover, the bank's cost income ratio averaged 80% from 1993 to 2003 and even exceeded 100% in 2002. Evidently, Dresdner Bank did not only have a risk problem, it also had a cost problem. For the first half of the period analysed, the risk problem originated from an unreasonably hazardous lending policy and an archaic risk management system (interviewee). Dresdner Bank did not make use of sophisticated risk models based on statistical methods. Hence, the price of loans was largely unrelated to the default risk until around 1997/98 when it introduced stochastic models and a capital market approach to determine the right price for risks (interviewee).³³

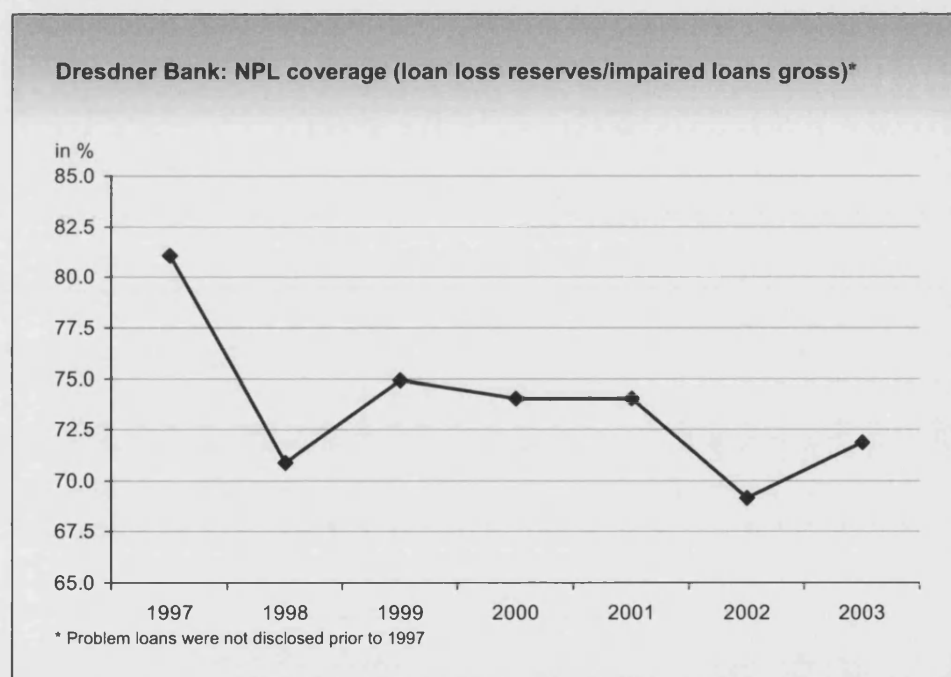


Once Dresdner Bank had the right risk management tools at hand, their use was held back by its ambition of building an international investment banking operation. It began granting inadequately priced loans to corporate clients, hoping to receive compensation for these unattractive lending conditions in the form of lucrative investment banking mandates (interviewee). Furthermore,

³³ Dresdner Bank uses KMV's quantitative analysis tools for managing its credit risks.

Dresdner Bank was keen to lend to corporate clients in many parts of the world where it actually lacked local expertise to correctly evaluate the risks. This overestimation of its risk management skills is a sign of managerial hubris, for which Dresdner Bank had to pay dearly.

For example, its 1997 results were burdened by DM 600 million of charges for the Asian crisis, where the bank's exposure was DM 4 billion³⁴ (Fisher, FT, 23 February 1998; *Süddeutsche Zeitung*, 27 March 1998). In the following year Dresdner Bank was battered by the economic crises in Latin America and Russia which required country risk provisions of DM 400 million (Dresdner Bank, Annual Report 1998, p. 37). Moreover, Dresdner Bank was invested in the LTCM hedge fund that collapsed, requiring a write-down of DM 240 million in 1998 (Sen, Metzler Equity Research, 19 January 1999).



However, the largest loan loss provisions had to be booked for its domestic engagements. Even on its home turf, Dresdner Bank's risk management failed. As the economic situation in Eastern Germany did not brighten, substantial loan loss provisions for corporate customers became necessary. In 1998, provisions for Germany soared by 52% (y-o-y) to DM 2.1 billion (Dresdner Bank, Annual Report 1998). German borrowers, besides Latin

American and North American borrowers, remained the main reason for high loan loss provisions in the following years (Allianz, 20-F 2003, pp. 85-107).

Dresdner Bank's loan portfolio peaked in 2001 with EUR 247 billion of outstanding customer loans. In the same year, the net interest margin was 0.79%, down from 1.86% in 1993, and management had to book a total of EUR 1.9 billion loan loss provisions. That was 45% of net interest income. Against the background of this record loan loss, a NPL coverage consistently below 100%, which actually dropped from 81% in 1997 to 72% in 2003, raised regulators' concerns about the bank's risk management (interviewee). The serious state of Dresdner Bank's loan portfolio became evident when management, under the pressure from Allianz and possibly the regulatory authorities, had to set up the IRU (Institutional Restructuring Unit) at the end of 2002.³⁵ Swedish bank manager Jan Kvarnström, who had successfully completed a similar task at one of Sweden's largest banks, was recruited to lead and ultimately liquidate the IRU when its job was completed.

The IRU³⁶ pooled Dresdner Bank's non-performing loans, non-strategic loans and private equity investment amounting to a total of EUR 35.5 billion (Dresdner Bank, Annual Report 2002; Janssen, Metzler Equity Research, 21 March 2003).³⁷ Its purpose was to free up risk capital by reducing risk-weighted assets, primarily through the sale or securitisation of loan portfolios (Dresdner Bank, Annual Report 2002, p. 18; Allianz, 20-F 2003, pp. 85-107). Through the transfer of the bank's EUR 123 billion mortgage activities to a separate company³⁸, Eurohypo, reduced lending, and the progress at the IRU, risk-weighted assets were scaled back by EUR 87 billion between 2000 and 2003. Consequently, Dresdner Bank's tier 1 ratio rose again, after having bottomed out at 5.5% in 2001. Eventually, the IRU was closed down in September 2005, after it had completely wound up the remaining loans.

³⁴ These were mainly country risk provisions for Indonesia, South Korea and Thailand.

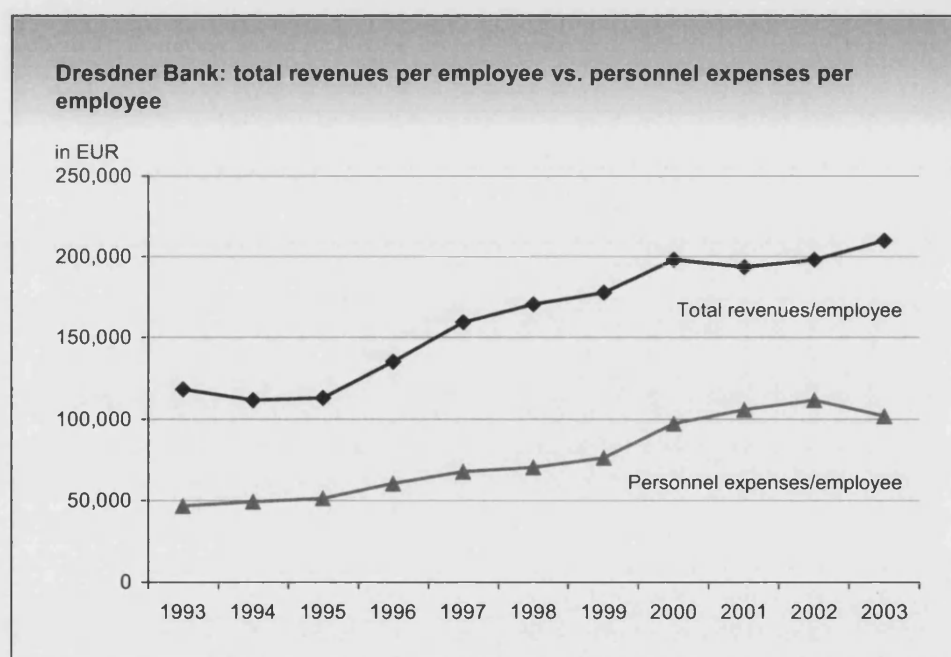
³⁵ Dresdner Bank's board members were frequent visitors to the German regulatory authority BaFin at the time (interviewee).

³⁶ The IRU held EUR 14.8 billion in performing and non-strategic loans, EUR 6.9 billion non-performing and EUR 1.1 billion potential problem loans. Risk provisions for the IRU were EUR 4.1 billion (Janssen, Metzler Equity Research, 21 March 2003).

³⁷ Some of these non-strategic loans originated from the cooperation with BNP in Eastern European countries (interviewee).

³⁸ Around EUR 25 billion of risk-weighted assets from Dresdner Bank's mortgage banking activities were transferred to Eurohypo.

The IRU was a cornerstone of Dresdner Bank's "Turnaround 2003"-Programme launched in 2002. This restructuring drive supplemented the existing restructuring plans introduced in 2000. In total 15,700 job cuts were planned. By the end of 2003, a headcount reduction of 9,910 had taken effect (Allianz, 20-F 2003, pp. 85-107).³⁹ As a result of these drastic measures, the number of full-time employees stood at 34,998 in 2003 compared to 45,508 in 1993, paving the way for some EUR 2 billion of cost savings (Dresdner Bank, Annual Report 2002, pp. 16-19; *The Economist*, 17 August 2002). Indeed, the proportion of personnel expenses relative to the bank's total operating expenses before risk provisions declined from 62% in 1993 to 52% in 2003. However, this picture is distorted by the significant restructuring charges booked under other operating expenses, which for the years 2002 and 2003 alone amounted to EUR 1.1 billion (Dresdner Bank, Annual Report 2002, p. 18; Allianz, 20-F 2003, pp. 85-107).



For the whole period analysed personnel expenses per employee rose by a compound annual growth rate of 8.1%, compared to an average rise of 5.9% p.a. in revenues per employee. This partly explains the continuously climbing cost income ratio, which exceeded 100% in 2002 and averaged 80% for the time between 1993 and 2003. The increase in personnel expenses was driven

³⁹ After the integration of the bank's asset management arm into Allianz, the 2,500 staff (2000) from this

by the takeover of Kleinwort Benson in 1995, the acquisition of Wasserstein Perella in 2000 and guaranteed bonus payments after the failed merger with Deutsche Bank.

In March 2000, Deutsche Bank and Dresdner Bank announced plans to merge, but Dresdner Bank called the merger off in April, posing an unusual kind of operational risk for itself. The reason for the failed merged was a dispute over the future of Dresdner Bank's investment banking arm Kleinwort Benson, which Deutsche Bank's investment bankers wanted to be sold after the deal. As Dresdner Bank's management did not want to accept this decision, they terminated the merger process (Willman, FT, 19 May 2000; Börsen-Zeitung, 7 April 2000; interviewee).

During the merger phase and after the deal was called off, a sense of uncertainty caused many investment bankers to leave Kleinwort Benson (interviewee). Dresdner Bank felt that this exodus had to be stopped and therefore offered guaranteed bonus payments. Yet, it appears to be a general management problem that in phases of crisis the best performers usually jump ship first and underperformers are likely to hang on to the planks. While in 2000 personnel expenses rose by 27% and revenues increased by 12% per employee, the following year saw revenues down by 2%, but personnel expenses up by another 9%, mirroring the deteriorating capital market situation and lavish compensation conditions (Barber et al., FT, 12 April 2000; Willman, FT, 19 May 2000). CEO Fahrholz later said that the expenses to "secure Dresdner Bank's competitive position in investment banking" amounted to EUR 553 million in 2000 (Annual Report 2000, p. 6).

At the annual general meeting only two weeks after the failed merger, Dresdner Bank's management announced a EUR 3.5 billion investment and restructuring programme for the next three years. EUR 1.5 billion were allocated for the group's investment banking activities⁴⁰ and another EUR 1.5 billion were earmarked for asset management-related private customer business in Germany and Europe.⁴¹ In essence, the restructuring program

division no longer counted as Dresdner Bank employees.

⁴⁰ Most of that investment was for technology and to strengthen its the local presence in selected European countries.

⁴¹ EUR 0.5 billion were for investment in e-business activities.

comprised shedding 5,000⁴² jobs, scaling back lending outside Europe and the aforementioned closure of 300 branches in Germany (Hoymann, Metzler Equity Research, 22 May 2000). These investment and restructuring measures, along with the purchase of Wasserstein Perella in September 2000, were last attempts to breathe life into this decaying institution, to no avail. Notwithstanding its efforts, the failed merger with Deutsche Bank substantially and sustainably weakened Dresdner Bank in general and its investment banking operations in particular.

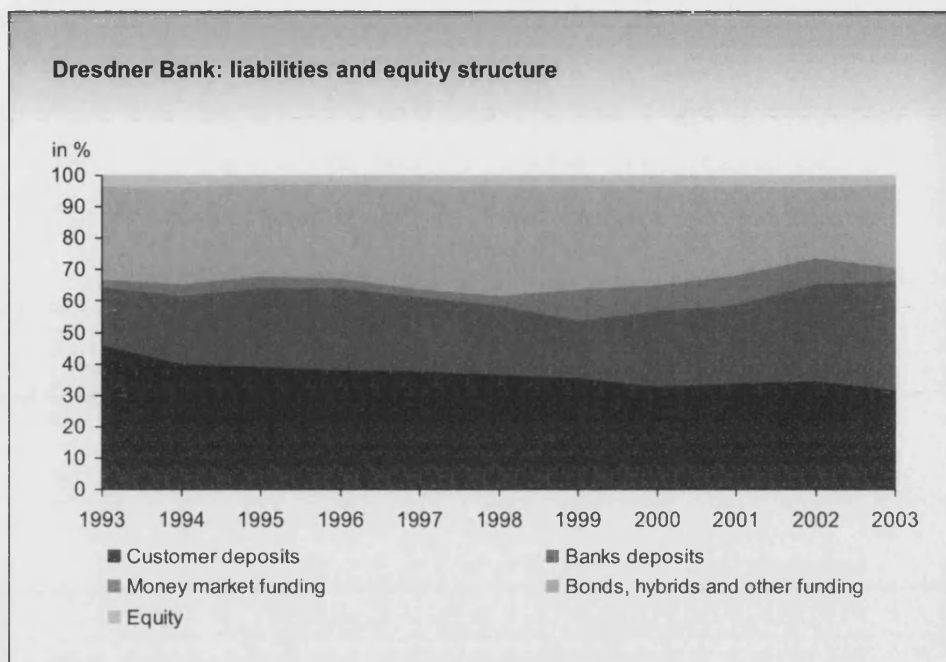
⁴² 2,900 jobs in retail banking and 2,100 jobs at the bank's headquarters.

5.9.4. Asset-Liability Structure

An analysis of Dresdner Bank's liability structure reveals that an average of 37% of its financing came from deposits, mainly from current accounts. At the beginning of the period analysed, 46% of the bank's funding still originated from deposits. The relative decline in deposits as a source of funding can be largely explained by developments that were not specific to Dresdner Bank. The declining interest rates in Germany during those years and the growing opportunities for retail clients to invest in capital market instruments were important factors. However, the weak customer deposit growth was compensated by a strong rise in deposits from other banks.

While customer deposits grew at a compound annual growth rate of 5.8% between 1993 and 2003, bank deposits increased by an average of 16.6% p.a. Consequently, Dresdner Bank's liabilities to other banks amounted to EUR 166 billion, i.e. 35% of total liabilities and equity in 2003 and were therefore above the EUR 153 billion relating to non-bank customers. It seems that Dresdner Bank offered these other financial institutions such attractive terms, that they preferred to deposit short-term excess liquidity rather with Dresdner Bank than through capital market products, such as money market funds. This high proportion of bank deposits certainly did not help increase Dresdner Bank's net interest margin.

Besides this strong rise in deposits from banks, Dresdner Bank also increasingly tapped the capital markets for funding, mainly in the form of money market instruments, hybrid capital and subordinated debt. In 2003, these sources of financing contributed EUR 27.6 billion i.e. 2.1% of total liabilities and equity. This compares to 1.1% in 1993. Shareholders' equity grew by a compound annual growth rate of 7.5%, below the bank's balance sheet growth of 9.6% p.a. Shareholders' equity made up on average only 3.1% of the bank's total funding, a fact reflected in the consistently weak tier 1 ratio.

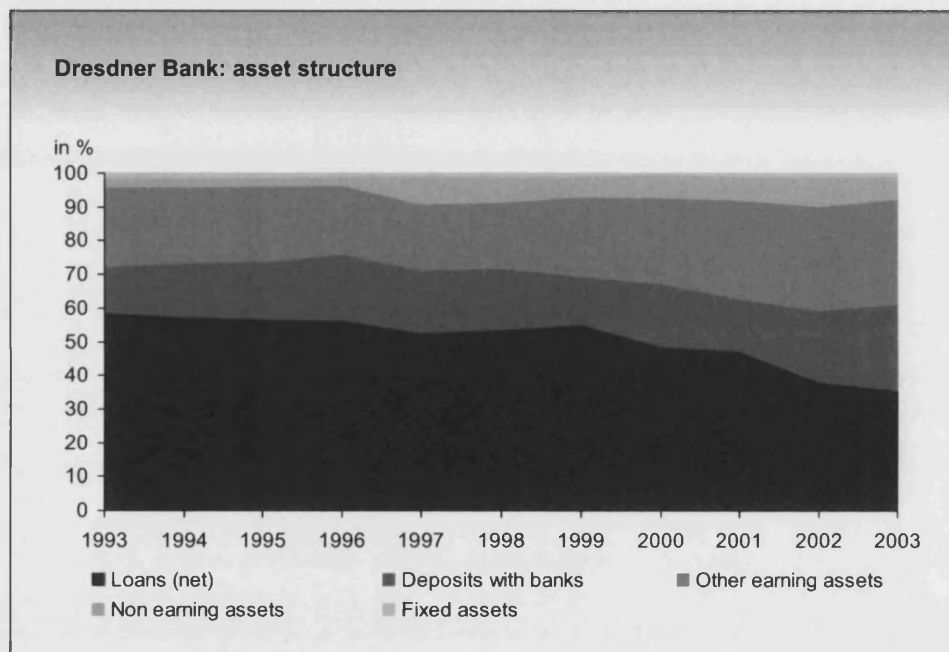


Dresdner Bank's tier 1 ratio averaged 5.8% for the period 1993 to 2003. This resulted from its expansive lending policy, which it did not abandon until 2001 despite poor net interest margins and constant loan impairments. Given the bank's strong exposure to the German economy, its 10% loan portfolio growth between 1993 and 2001 should be seen in the context of Germany's 1.7% GDP growth during the same years. Considering that the bank did not gain market share that would have justified such strong growth of loans and that the risks of its loans were not reflected in the interest rates charged, the massive loan losses should not have caused any astonishment.

During the decade under review, the tier 1 ratio reached a low of just 5.1% in 1996. Unsurprisingly, Dresdner Bank raised some DM 1.6 billion fresh equity in July of the following year. At the time, CEO Sarrazin explained the need for this capital increase was to enhance the scope for strategic options in the field of investment banking and asset management (Börsen-Zeitung, 30 July 1997; Dresdner Bank, Annual Report 1997).⁴³ Since the reasons given highlighted expansion and not capital strengthening, rating agency Standard & Poor's cut Dresdner Bank's credit rating four months later, expressing its concern about the deterioration in its tier 1 ratio (Börsen-Zeitung, 14 November 1997).

⁴³ Dresdner Bank increased its capital four times, by raising fresh equity, adding in total EUR 2.3 billion.

When it introduced the economic value added concept in 2002, Dresdner Bank began comparing returns with the cost of capital, taking into account the underlying risk (Dresdner Bank, Annual Report 2002, p. 19). Subsequently, management scaled back the bank's risk-weighted assets, i.e. its loan portfolio. A more selective lending policy with risk-adequate pricing was one important aspect of that process. Another, more immediate, effect was brought about through the deconsolidation of Deutsche Hyp, Dresdner Bank's mortgage bank. Deutsche Hyp's East German mortgage portfolio represented a potential threat for Dresdner Bank. For example, in 2000 it was responsible for EUR 500 million of Dresdner Bank's total EUR 1.6 billion loan loss provisions.⁴⁴



As Dresdner Bank's German competitors, Deutsche Bank and Commerzbank, had similar sentiments with regard to their mortgage banking arms, they decided to merge these operations into one big German real estate bank, called Eurohypo. Following the merger, each bank held around a third of the new entity and thus could deconsolidate its stake.⁴⁵ In the case of Dresdner Bank, this reduced total assets by EUR 85 billion in 2002. Deconsolidating Deutsche Hyp, coupled with a more restrictive credit policy, contributed to a

⁴⁴ This was offset by the sale of 2.5% of Munich Re shares in November 2000 (Dresdner Bank, Annual Report 2000, p. 7).

⁴⁵ Dresdner Bank held 28.5% of Eurohypo and it was accounted for at equity (Fitch Ratings, 2004).

44% decline in the bank's lending volume (y-o-y) in 2002 and an additional 16% drop (y-o-y) in 2003 (Dresdner Bank, Annual Reports 2002 & 2003). While the reduced risks made Dresdner Bank's loan book manageable again, these measures inevitably had an effect on interest income. Net interest income fell from EUR 4.4 billion in 2001 to EUR 2.5 billion in 2003 (Dresdner Bank, Annual Reports 2002 & 2003). Subsequently, Dresdner Bank had to adjust its cost base to its lower revenues in order to boost profitability.

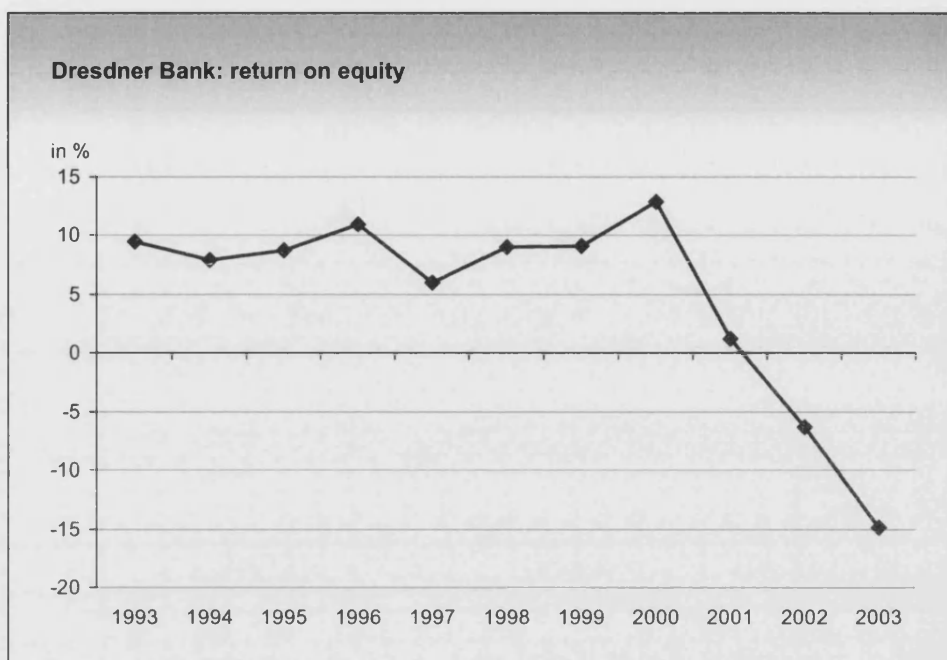
5.9.5. Profitability

With an average cost income ratio of 80% and loan loss provisions that ate up around 32% of net interest income p.a., it is obvious that Dresdner Bank's profitability was poor in most years between 1993 and 2003. Its return on equity after tax was on average 4.9% during the period analysed and thus significantly below its cost of equity. Dresdner Bank disclosed its cost of equity (8.85% after tax) for the first time in 2003 (*Börsen-Zeitung*, 15 August 2003). Although Dresdner Bank did not publish its cost of equity earlier, it may safely be assumed that it was not below 8.85% in 1993 to 2003.⁴⁶

Maybe the net loss of EUR 1,978 million in 2003, with an implicit return on equity of -15%, was the right time for Dresdner Bank to develop a shareholder value concept that compared cost of equity with return on equity. In the previous year, Dresdner Bank had already run up a loss of EUR 935 million. These significant losses originated from high loan loss provisions and administrative and personnel costs that could not be adjusted at the same pace as revenues had been falling since 2000. In 2003, total operating income was down by 28% from 2000, while operating expenses before loan losses declined by only 20%. The 2003 result of -15% ROE after tax was in sharp contrast to the initially envisaged +15% target for 2003 (Dresdner Bank, Annual Report 2000, p. 6).

In 1994, management announced a target return on equity after tax of 12% (*FAZ*, 21 May 1994; *Börsen-Zeitung*, 20 May 1995). Four years later, it reiterated this profitability criterion, stating a pre-tax ROE target of 20-25%, which is the equivalent of 12-15% after tax, assuming a tax rate of 40% (*Süddeutsche Zeitung*, 27 March 1998; *FAZ*, 27 March 1998). In order to achieve this goal, CEO Fahrholz conceded that the bank should no longer attempt "to be present in all business areas, everywhere", but should focus on "high-level advice in the securities and capital markets business, to corporates and institutions as well as to private clients and in asset management" (Dresdner Bank, Annual Report 2000, p.6). It is questionable whether sweeping statements of this kind deserve to be described as "focused strategy".

⁴⁶ Using CAPM a COE exceeding 9% is derived for the entire period after 1992 and prior to the takeover by Allianz.



As discussed in the section on income structure, Dresdner Bank delivered a mediocre return on equity despite the continuous sale of its non-bank holdings. In 1994 the market value of Dresdner Bank's non-bank shareholdings amounted to DM 15 billion, i.e. around EUR 7.7 billion (Dresdner Bank, Annual Report 1994, p. 46). By year-end 2000, the market value of the entire non-bank shareholdings of the Dresdner Bank had reached EUR 17.6 billion. The highest was the 10% stake in Allianz⁴⁷ (Dresdner Bank, Annual Report 2000, p. 67). Falling equity markets and the need to accelerate the sale of the non-bank shareholdings diminished the value of Dresdner Bank's investments to EUR 4.6 billion by the end of 2003.⁴⁸ Excluding the netted non-operational disposal gains for the period analysed, Dresdner Bank's pre-tax ROE would have been 3.1 percentage points lower. On an after tax level, assuming a tax rate of 40%, it would have reduced Dresdner Bank's return by another 1.9 percentage points to an average of just 3% ROE after tax.⁴⁹

⁴⁷ The eight largest investments were: Bilfinger & Berger (25.1%; EUR 118 million); Heidelberger Zement (17.7%; EUR 540 million); Dyckerhoff (10.5%; EUR 105 million); Allianz (10.0%; EUR 9,847 million); mg technologies (9.4%; EUR 231 million); Munich Re (7.4%; EUR 4,999 million); Karstadt Quelle (7.1%; EUR 277 million); BMW (5.0% EUR 1,130 million) (Dresdner Bank, Annual Report 2000, p. 68).

⁴⁸ This comprised a EUR 1.7 billion investment in Allianz shares (4.5%) and a EUR 1.6 billion stake in Munich Re (7.3%).

⁴⁹ Dresdner Bank's tax rate was 41% on average for the years 1993 to 2003. While Dresdner Bank paid up to 59% taxes in 1997, it also enjoyed substantial tax breaks from 2000 until 2003 amounting to EUR 1.2 billion.

5.9.6. Conclusion

European integration was a recurring theme in Dresdner Bank's annual reports.⁵⁰ Management made frequent references to the importance of the European market and the bank's international opportunities. It even regarded Euroland as the bank's domestic market, although it held less than 5% of the German retail market (Dresdner Bank, Annual Report 1998). However, Dresdner Bank did not benefit from the opportunities that European market liberalisation and globalisation brought about in the 1990s. On the contrary, the enlarged set of opportunities lured it into too many temptations, with management neglecting the need to prioritise.

There is very little that suggests a strategic pattern or coherent action at Dresdner Bank during the decade under review. The bank's pronounced expansion into Eastern Germany in the early 1990s was followed by visible signs of internationalisation. Notwithstanding any potential pitfalls, Dresdner Bank wanted to be international for the sake of being international. Internationalisation was a strategic objective in its own right. The bank rapidly expanded around the world through lending on terms and conditions that did not take account of the risk and price environment. Examples were the US loan portfolio, the bank's exposure to South America and its lending to Asian countries. All of these engagements led to significant loan loss provisions. Moreover, the bank's initial lending spree was not even intended as a door-opener for subsequent investment banking mandates, but merely fulfilled the purpose of having an international presence.

However, this lending policy changed when the bank realised it could use its lending facilities as a means of getting investment banking mandates. Subsequently, Dresdner Bank began granting inadequately priced loans, in return for corporate finance mandates. Besides a clash of cultures within the bank, the effort of linking traditional German commercial banking with transaction-oriented investment banking created trading and credit risks that were beyond management's control. Although Dresdner Bank's move into investment banking through the acquisitions of Kleinwort Benson, caused

⁵⁰ Examples can be found in Dresdner Bank's Annual Report 1997 (page 65), Annual Report 1998 (page 35), Annual Report 2000 (page 22).

management to reconsider its high street banking approach, the measures to raise profitability at Germany's largest retail banking network were not enough.

The fragility of Dresdner Bank's business model became evident in the wake of the failed merger with Deutsche Bank in 2000. By then, Dresdner Bank had built up large administrative and personnel costs and a huge loan portfolio with insufficient loan loss reserves. Despite the continuous sale of its non-bank holdings, the bank's profits were not sufficient to cover even its cost of equity. Instead of having used this capital cushion to stringently rebuild and focus its business model, Dresdner Bank's management pursued too many opportunities with too little vigour.

In many ways, Dresdner Bank wanted to follow in the footsteps of its bigger rival Deutsche Bank. This "me-too" strategy was most obvious in investment banking. However, Dresdner Bank did not address the challenges and opportunities with the same strategic rigour as Deutsche Bank. Its too passionate East German expansion prevented substantial cost reductions in retail banking and its move into international investment banking began too late and had not been completed by the time the investment banking cycle turned. Moreover, during a period when Deutsche Bank had just three different CEOs, Dresdner Bank had five, three of whom were unable to prepare a handover of office. This draws attention to Dresdner Bank's supervisory board members and the negligence of their duty. Thus, it appears quite appropriate that Allianz, who as the largest shareholder was on the supervisory board all these years, had ultimately to bear the brunt of its own negligent supervisory role and mediocre personnel management.

6. Conclusions

6.1. Introduction

This research set out to explain why banking integration remained slow during the first decade of the European Common Market. More specifically, the aim has been to explore how British and German banking strategies differed in an increasingly integrated European economic system and why market liberalisation seemed to provoke two fundamentally different strategic reactions among banks, neither of which appears to have promoted European banking integration to any significant degree.

Most research into European banking integration has involved an analysis of aggregate data in the context of macroeconomic research projects. However, there is little research into European banking integration that considers the interdependency of the macro and micro levels. Therefore, this research approached the macroeconomic integration of the European banking sector through a microeconomic perspective, namely the analysis of realised banking strategies.

The objective has been to study major decisions made by a few selected banks in Britain and Germany from the beginning of the Single European Market in 1993 until 2003 in an attempt to fill the gap between the ample research into the European banking sector as a whole and the few isolated case studies. Most existing case studies on banks concentrate either on a time span that is too short to identify strategic patterns or focus too exclusively on specific business strategies (e.g. “retail banking strategy”).

This research has applied a methodology that is unique in the study of European financial integration and the banking sector. Rooted in Giddens’ ontological concept of structuration (Giddens, 1984, 1988), it recognises that structure and agency are complementary forces. This approach takes into account the interdependence of the macro and micro levels of a financial system. Based on the view that an examination of continuous processes in context sheds light on the interconnected levels of analysis (Pettigrew, 1990), the method chosen to study the interdependence between the European

financial system and eight of its largest institutions in two countries was a longitudinal comparative case study.

In order to strengthen the validity of this research, a variety of different methods have been used. Triangulation has been achieved through two qualitative methods with two different data sources and one quantitative method using a third set of data, supplemented by a few formal interviews and numerous informal interviews. The four British and four German banks were studied through accounting analysis, archival research and a qualitative database survey. This research has analysed the realised corporate strategies of publicly listed banks as opposed to emerging business strategies at non-listed institutions. Consequently, the tightly drawn research design did not permit an investigation of internal organisational issues, such as power politics within the banks, which usually condition any decision-making process.

This concluding chapter comprises five sections in addition to this introductory one. The second section summarises the findings of each case study and then, in section three, ties together all eight cases in order to identify cross-case patterns. Discussing the findings and the cross-case pattern analysis refers back to chapter three on corporate strategy and the applicability to the banking sector. Subsequently, section four answers the research questions about how and why British and German banking strategies differed between 1993 and 2003. Moreover, it takes up the question of agent-structure interdependence. Since Giddens' theory of structuration has been the guiding ontological concept of this research, this section also reviews the ramifications of the banks' strategies for European financial integration. Section five shows which questions have not been answered and pinpoints the limitations of this research by putting forward ideas for complementary research projects. Based on the experience obtained from the case studies, section six contains an epilogue and the author's tentative outlook for the European banking landscape.

6.2. Discussion of the findings from each case study

In 2003, the last year of the period analysed, three of the eight banks delivered a loss; all of them were German. The only German bank that did not make a loss was Deutsche Bank. During the period analysed, Deutsche Bank managed to transform its business model from a domestic commercial bank with a weak retail client base to a bank largely operating in international investment banking. This colossal rebuilding of its business model resulted from management's view in the early 1990s that it had to reduce its exposure to Germany and that it should scale back its transformation activities and instead focus on transaction services. This meant expanding into international investment banking.

Besides achieving the highest average ROE of all four German banks examined, Deutsche Bank had the lowest loan loss provisions relative to its net interest income between 1993 and 2003. From this, it may be concluded that its decision to reduce its loan portfolio and to diversify internationally was right. Yet, expanding into international investment banking contributed to a strong rise in personnel expenses. At 77%, Deutsche Bank's cost income ratio was the highest ratio of all eight banks covered by this research. However, in all fairness to the other German banks, Deutsche Bank's transformation process was greatly assisted by the continuous sale of industrial holdings, which bolstered its profits. None of the other German banks could rely on such a comfortable capital cushion. This is also reflected in the fact that Deutsche Bank had the highest average tier 1 ratio of the German sample, albeit one percentage point below the average for the British banks.

The development of Deutsche Bank during the period analysed shows a clear pattern, which suggests that the group pursued a coherent and consistent strategy. The bank's strategy was based on management's belief that it could not change the structure of its domestic playing field and that it effectively had to reduce its exposure to the German market. This strategic insight paired with the growing significance of disintermediation and the prospect of leveraging Deutsche Bank's long-standing relationship with large industrial firms, paved the way for its shift towards investment banking. The lesson one can take away from studying Deutsche Bank during this period is that if you are

exposed to an unfavourable environment and you can neither change the structure to your own benefit, nor carve out a profitable niche within your area of expertise, you must leave.

Two other banks among the eight studied reinvented themselves. These were the Royal Bank of Scotland (RBS) and HSBC. RBS showed the strongest revenue growth of all the banks analysed. Its total operating income increased by a compound annual growth rate of 29% p.a. between 1993 and 2003. In absolute figures, that constitutes a rise from GBP 1.5 billion in 1993 to GBP 19.3 billion in 2003. RBS concentrated on the domestic market and actively participated in consolidation in order to grow. Growth by itself is not necessarily a strategic achievement, but in the case of RBS this was consistently profitable growth, as, for example, illustrated by management's successful integration of NatWest after its hostile takeover.

During the period analysed, RBS' return on equity averaged 22%, thereby putting it in second place after Lloyds TSB's 29% (1993-2003). RBS' high level of profitability resulted more from operational excellence than from an overarching strategy. Management appeared to have a clear awareness of which businesses it wanted to avoid, while granting its key staff sufficient entrepreneurial freedom to develop innovative solutions. Its corporate strategy was the successful management of business portfolios with clear business strategies that did not follow a common rule. Thus, RBS showed a relatively unique and original pattern as it did not try to be everything to everybody. The lesson learned from RBS is not to talk about strategy, but simply to be good at what you are doing and consistent.

While RBS reinvented itself within its domestic market, an environment it was familiar with, HSBC's transformation process could have hardly taken place in a more international setting. Its pivotal move was its entry into the British market in 1992/1993. The acquisition of Midland Bank paved the way for HSBC's internationalisation strategy in retail and commercial banking. In the following years, it developed a global network in private wealth management, high street banking, and commercial banking through a series of takeovers.

HSBC's management demonstrated great skill in mastering the integration of its numerous international takeovers, thus turning itself into a global multi-local

banking group. HSBC grew its total operating income by an average of 13% p.a., the second highest growth rate of the eight banks, after RBS. In addition to such strong revenue growth, HSBC had the second lowest average cost income ratio in the sample between 1993 and 2003, not least as management avoided overly expensive investment banking endeavours. HSBC demonstrated how a successful global strategy has to recognise local differences, while reaping the benefits of the scale and scope of internationalisation.



In contrast to HSBC's decision not to acquire an investment bank, Commerzbank wanted to buy one in the early 1990s, but failed to do so. Commerzbank was still in the process of organically building its investment banking operations when the capital markets turned down in 2000. It reacted swiftly to the altered macroeconomic environment and launched drastic cost-cutting measures that went beyond its investment banking operations. Despite Commerzbank's global and investment banking aspirations in the 1990s, management did not lose touch with its traditional clientele of small and medium-sized enterprises. Moreover, it remained committed to retail banking in Germany throughout the 1990s.

The analysis of Commerzbank's corporate strategy between 1993 and 2003 leaves the impression of an institution that eventually benefited from being a latecomer. Apart from some small successes in building Germany's largest online bank and gaining a leading position on the German asset management market, Commerzbank was the least impressive bank. Yet, this uninspiring and slow "strategic" muddling through left it in a position from which it could be quickly turned around and set on a more focused course as of 2003.

Commerzbank had less rigorously tried to break out of Germany's financial and socio-economic structure in which it was deeply embedded. Unintentionally, it remained part of this structure and as of 2001 recognised that it could neither change it, nor break out of it, but had to carve out its little and carefully identified niches within retail banking and SME commercial banking. The lesson learned from Commerzbank is that slowness may not simply save the agent from the trial and error mistakes of the first-mover, but may even prevent it trying to escape too quickly and radically from a structure in which it was far more firmly embedded than appeared at first sight.

The case study on Commerzbank also concluded that managerial stability is likely to have worked to its benefit. The importance of management, particularly the role of the CEO, was very apparent in the case of Barclays. Barclays went through two phases during the period analysed, each distinctly shaped by its CEO at the time. Martin Taylor's leadership from 1993 to 1997 was dominated by restructuring and the introduction of stringent cost and risk controls. Besides putting decent risk and credit management tools in place, Barclays under Taylor rethought its financial strategy and particularly its capital structure, leading to a massive share buyback programme.

In many ways Taylor, with his non-banking background, was the right person for the position as Barclays' CEO after the bank's first ever loss in 1992. His unbiased approach and sharp intellect allowed him to analyse the situation at Barclays thoroughly. Without Taylor's managerial rigour in addressing cost, risk and cultural issues, his successor Matthew Barrett would not have been able to induce a new growth paradigm, prompting revenues to rise again.

During the period analysed, Barclays broadened its product range in retail banking, but remained focused on a few countries. The bank's corporate

banking moved in the other direction, as it internationalised while confining its activities to debt capital market services. The complementary nature of Martin Taylor and Matthew Barrett persuasively demonstrates that different times need different types of CEOs, emphasising the importance of leadership.

When the merger of the two Bavarian banks, Vereinsbank and Hypo-Bank, created HVB in 1997, a leadership battle of the two CEOs ensued. Albrecht Schmidt, CEO of Vereinsbank, which was the slightly bigger of the two banks, prevailed. Once the uneven merger was sealed, Vereinsbank's international profile dominated the new bank and paved the way for its "European bank of the regions" strategy. The idea was to build a network of European banks with regional characteristics sharing a group-wide transaction platform - a concept that was not unlike HSBC's successful "world's local bank" strategy. However, in contrast to HSBC, HVB suffered from a loan portfolio cluster risk.

The merger of Vereinsbank and Hypo-Bank meant that two inadequately provisioned banks with very similar loan portfolios were amalgamated, with detrimental effects for HVB's risk diversification and loan loss provisions. Thus, HVB had primarily a risk and not a cost-problem. In fact, its average cost income ratio of 65% (1993-2003) was the lowest of all four German banks analysed. Yet, the high loan loss provisions pushed the bank into the red and depleted its capital base. Measured by its tier 1 ratio, HVB had the weakest capitalisation of all eight banks and delivered an average return on equity of 4.4% between 1993 and 2003. The HVB case demonstrates that a plausible strategy alone is not sufficient for a bank's success. Moreover, it is a reminder that the geographical proximity of the two parties that merge may increase the likelihood of success but is certainly not sufficient for a prosperous deal.

In the case of HVB, geographic concentration became part of its problem. For Lloyds TSB, geographic focus meant local expertise and the possibility of reaping efficiency gains from proximity. From the late 1980s and throughout the 1990s, Lloyds' corporate strategy was strictly guided by the shareholder value principle. Thus, there was no other objective for management than to improve the bank's return on equity. Scale efficiencies were primarily achieved through domestic acquisitions, thereby shaping the competitive landscape in the UK retail banking market. Lloyds TSB was the bank with the best results and most impressive ratios in our sample, and yet this bank ended the period

in a strategic dilemma. Its own efficiency criteria and the fear of diluting its results by moving into new areas to promote revenue growth confined it to its domestic market.

Lloyds' strategy during the period analysed was predominantly shaped by the views of its long-serving CEO Brian Pitman. With his decision to establish a return on equity target as the single governing objective, he provided an operational framework for the group, which paved the way for the bank to increasingly focus on the British market. The great success of Lloyds TSB showed the importance of prioritising and not pursuing too many goals at once. However, it also brought to light the fact that the search for ever higher returns can lead to such a degree of concentration that it creates a dependence on a single national economy, depriving the bank of any growth prospects.

Unlike Lloyds, the devastating consequences of a lack of focus were exemplified by Dresdner Bank, clearly the worst bank of the eight studied. There is very little that suggests a strategic pattern or coherent action at Dresdner Bank during the period analysed. All that stands out is Dresdner Bank's desire to be international for the sake of being international, to such an extent that internationalisation seemed to become a strategic objective in its own right. However, Dresdner Bank did not benefit from the opportunities that European market liberalisation and globalisation brought in the 1990s.

It is clear that the enlarged set of opportunities lured Dresdner Bank into too many temptations, with management neglecting the need to prioritise. The bank rapidly expanded around the world through lending on terms and conditions that did not take account of the risk and price environment. Moreover, its expansion into international investment banking contributed to rising operating expenses that were not matched by revenue growth. All of these engagements led to significant loan loss provisions and a continuously deteriorating cost income ratio, making its average performance the worst of all the banks analysed. In many ways, Dresdner Bank wanted to follow example its bigger rival Deutsche Bank, but its management pursued too many opportunities with too little vigour. Moreover, the frequent changes of CEO did not help to maintain a single strategic direction.

The author of this thesis subscribes to Mintzberg's understanding that "strategy" is a "strategy process" which comprises planning, positioning, and the use of ploy and perspective, which in retrospect, may feature some pattern. Thus, strategy becomes the mediating force between an organisation and its environment, that is, between the internal and the external context (Mintzberg, 1987, p. 15). Notwithstanding the differentiated view of strategy offered by Mintzberg, this research stands in the tradition of Porter's approach to studying corporate strategies, as discussed in chapter three. Thus, for the purpose of this research strategy has been understood as the changing position over a period. The changed corporate positions are analysed with hindsight to identify strategic patterns. Patterns are defined as the result of consistency of behaviour over time (Mintzberg et al., 1998).

Mintzberg provides a definition of strategy as a pattern, stating that strategy "is consistency in behaviour, whether or not intended" (Mintzberg, 1987b, p. 12). The case study on the Royal Bank of Scotland, arguably the most successful bank in the sample, showed that there was no clear pattern of strategic positioning. While there was no clear pattern over time, a review of RBS' corporate strategy revealed that its role as an important consolidator in the British financial services industry, its multi-brand strategy and sound risk management were essential for the bank's profitable growth. RBS' impressive development can be better explained by Porter's view that the "essence of strategy is choosing what not to do" (Porter, 1996, p. 70). As a result, the Royal Bank of Scotland achieved "a unique and valuable position, involving a different set of activities" (Porter, 1996, p. 68). Moreover, RBS met the necessary condition for achieving superior profitability, namely operational effectiveness.

Unlike RBS, Deutsche Bank, arguably the best bank from the German sample, showed a coherent strategic shift, most obviously from the changed earnings composition (see diagram in case study). Yet, this commitment to expand into international investment banking, while still being rooted in the German SME and retail client markets, made this transition nearly incompatible, as it ran counter to the necessary condition for a sustainable strategic position, which according to Porter requires trade-offs (Porter, 1996). And yet, what contributed to Deutsche Bank's relative success is the uniqueness of its strategy, pursued with sufficient stamina. Thus, Deutsche Bank's strategy

supports the view that “uniqueness” is indispensable for a successful strategy (Henderson, 1989; Porter, 1996), a theory that, in fact traces its origins to Sun Tzu’s ancient writings on strategy, as elaborated in chapter three of this thesis.

The case studies showed that, as well as avoiding the pitfall of going after too many opportunities and failing to pursue an original strategy, successfully managing volatility is vital for a prosperous banking strategy, whereby volatility refers to earnings, profit and organisational volatility. Organisational volatility comes in the form of personnel fluctuation, divisional and reputed “strategic” reorganisations, which deprive employees of their sense of orientation. Stability is a key factor for operational progress and an organisation’s profitability can be enhanced by managing volatility. Thus, managing volatility should constitute a primary strategic task. Strategic management therefore becomes the managing of risks, i.e. financial and organisational risks. As risk emerges in dealing with external conditions, a company needs to be analysed in its environment. Risk and strategy analysis respond to complexity by concentrating on the essential structural factors which determine the sensitivities of a system. This research concludes that risk management needs to be given greater prominence in corporate strategies.

6.3. Cross-case pattern analysis

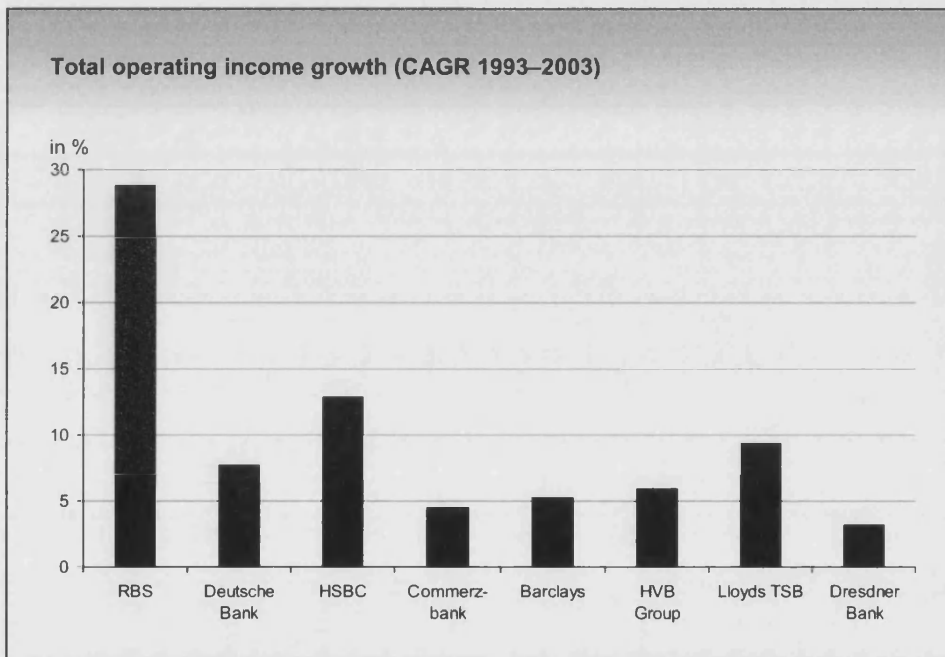
The preceding paragraphs summarised the strategies or, in some cases, simply the development of the eight banks analysed for this thesis and drew a direct comparison between them. What follows is a cross-case pattern analysis covering all the banks. At first sight the comparison seems to reveal national patterns but in fact many of these national characteristics can be explained by bank-specific strategic decisions, which are discussed in the case studies. In chapter three of this research Porter's five forces framework was applied to the banking industry and provided the theoretical framework for the analysis of the eight banks in two different national economic structures, against the background of the enlarged opportunities for banks to operate across the EU. By analysing and comparing the strategies of the eight banks in this changing national and European environment, using a modified version of Porter's model, this research substantiates Giddens' theory of structuration.

Applying Porter's five forces framework, as outlined in chapter three (see 3.4.), this research has explained the changing competitive landscapes in the UK and Germany. The findings from the case studies show that the consolidation in British banking helped to slow down the decline of net interest margins. On the one hand, the greater concentration of British banking during the period analysed strengthened the banks position vis-à-vis retail clients as providers of cheap funding, while on the other hand deterring potential entrants into British high street banking.¹

Moreover, the higher market concentration weakened retail clients' position as "buyers" of banking products and services, thus reducing competitive pressure on banks. The widespread bancassurance approach of British banks meant that retail clients who turned away from traditional banking products for savings and sought insurance-based solutions, for example to save for old age, could still be retained as clients within the same banking group. In Germany, the much more fragmented banking and insurance market resulted in an entirely different competitive structure.

¹ The first major inroad of a foreign bank into the British retail market was the acquisition of Abbey National by Spain's Banco Santander in autumn 2004.

Compared to the UK, Germany's fragmented banking and insurance market left clients to choose between many more providers of financial services. To attract deposits banks had to offer competitive interest rates, putting pressure on net interest margins. Entering the German banking market was relatively easy, as demonstrated by Germany's automobile industry, which set up banks to finance car sales, and the inroads made e.g. by Citibank of the USA and Holland's ING direct. These examples suggest that barriers to entry were lower in Germany than in the UK.



The consolidation of the British banking market explains a significant proportion of the strong revenue growth at the four British banks. The British banks' revenues grew by a CAGR of 14% between 1993 and 2003, much more strongly than their German peers, which delivered a compound annual growth rate of 5%.² During this period, German GDP grew by a compound annual growth rate of 1.4% while British GDP grew by an average of 3.0% p.a. The better shape of the British economy contributed to higher demand for banking products and kept risk provisions low. The fact that the British economy fared better during the decade analysed accounts for an important,

² The deconsolidation of the jointly owned mortgage bank of Deutsche Bank, Dresdner Bank and Commerzbank reduced the banks' revenues somewhat in 2002, but can be regarded as negligible for the whole period analysed.

albeit unquantifiable, part of the revenue growth of British banks and facilitated mergers and acquisitions in the banking sector.³

For example, the impressive average annual growth rate of 29% at RBS is largely due to the quantum leap resulting from the NatWest takeover (2000). Other important takeovers were Lloyds' purchase of TSB (1995) and Barclays' acquisition of Woolwich (2000). HSBC was the least involved in the consolidation of the British banking market but achieved a 13% revenue growth rate p.a. as a result of numerous international takeovers such as the acquisition of Republic National Bank of New York (1999), Credit Commercial de France (2000) and Household International (2003).

Besides the merger of Vereinsbank and Hypo-Bank, all other relevant acquisitions made by the German banks were in international investment banking. Most prominent were the acquisition of Bankers Trust by Deutsche Bank (1998) and the takeover of Kleinwort Benson by Dresdner Bank (1995). The fragmented German banking market, with around two-thirds of the market being either state-owned savings banks or the mutual banking organisation (cooperatives), did not foster a consolidation process. The prevailing three pillar structure (savings banks, cooperative banks and private commercial banks), has prevented banks from merging with or acquiring institutions from other pillars in the system. Although this market structure confined consolidation to each separate market segment, this cannot be accepted as an excuse for weak revenue growth. After all, it can be expected that management's analyses of market structures identify new means of growing revenues.

Deutsche Bank's management recognised the limited growth prospects on the bank's home market and concluded that it should expand internationally. By focusing on international investment banking and exploiting the opportunities arising from increasing disintermediation, it achieved average revenue growth of 8% p.a., the highest of its German peers. Deutsche Bank succeeded in rebuilding its business model as it was the first of the large German banks to branch out in new directions. Moreover, it showed sufficient stamina and had enough capital to smooth the transition through the disposal of its investments.

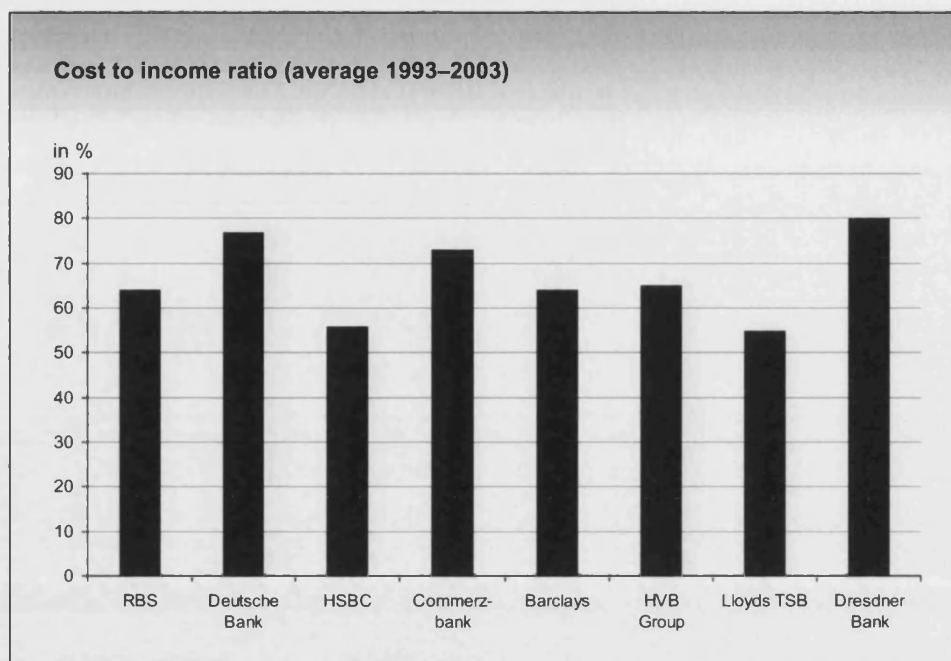
³ With the exception of HSBC, the British banks analysed generated the majority of their revenues in the UK.

The other German banks, especially Dresdner Bank and Commerzbank, either lacked the creativity and initiative to adopt a radically new approach to align their business model to prevailing market structures, or, in the case of HVB, suffered from deplorable risk management, that prevented it putting its strategies into practice as its capital base had been depleted.

HVB and Dresdner Bank also tried to rebuild their business models but failed for different reasons, as outlined in the case studies. Commerzbank made the least effort to transform its business model and as result of its phlegmatic approach it remained most embedded within the German financial structure. Not having embarked on the colossal transformation process in investment banking, it was able to adjust its business model relatively swiftly within the existing structure, carving out profitable niches from 2002. Most likely Commerzbank would have been less successful with its new SME and retail banking strategy if Deutsche Bank, Dresdner Bank, and HVB had “stayed put” in the 1990s.

All four British banks also rebuilt their business models during the period analysed. However, in their case, the transformations revolved around gaining market share and streamlining processes. The British banks transformed their business models primarily by optimising scale and not by broadening scope. For example, the decision not to enter, or to exit, investment banking operations meant a reduction of scope and helped to keep them focused on few business activities. Despite the increase of size and substantial branch closures, the average cost income ratio of the four British banks fell from 62% in 1993 to only 57% in 2003. This improvement was mainly driven by Barclays and Lloyds TSB, which had the weakest revenue growth of the four British banks analysed, lending support to the argument that there are limits to scale efficiency in banking.

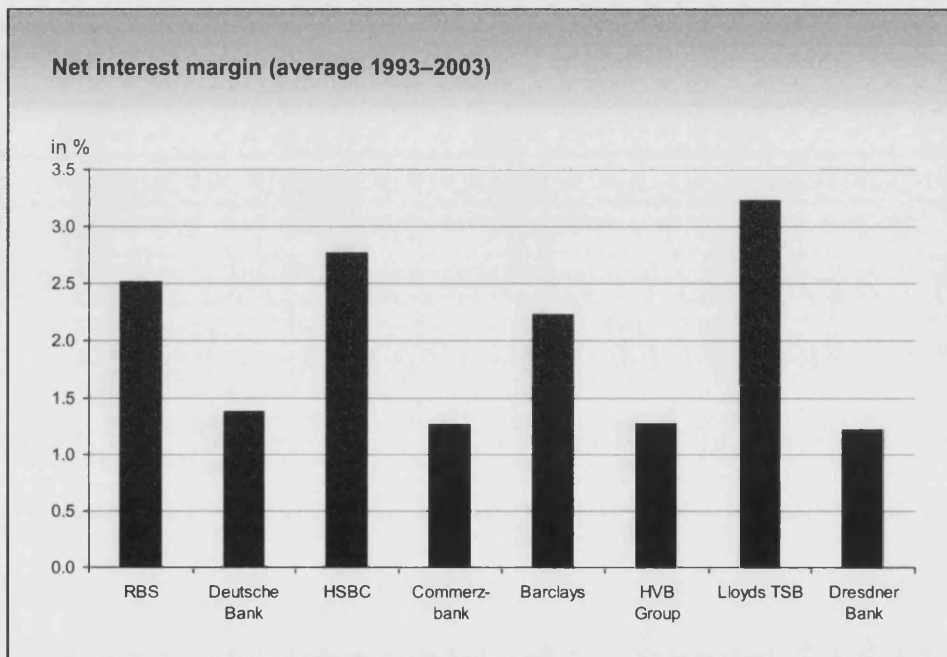
While Porter includes economies of scale as a barrier to entry (Porter, 1998), the findings of this research confirm those studies about efficiency in banking that indicate that there are hardly any economies of scale at group level. As discussed in section 3.4.2. the analysis of the eight banks corroborates the view that a bank’s size does not seem to have a major effect on its performance (Benston et al., 1982; Gilligan et al., 1984; Molyneux et al., 1996; Walter, 1999; Berger, 2000; Berger et al., 2000; Smith & Walter, 2003).



In 1993, the four German banks had an average cost income ratio of 62%, which was the same as their British counterparts. While RBS, HSBC, Barclays and Lloyds TSB continuously reduced their cost income ratios to an average of 57% by 2003, all four German banks contributed to the higher average cost income ratio calculated for 2003. The cost income ratio of the German banks was on average 17 percentage points higher in 2003 than in 1993. Deutsche Bank's cost income ratio was 22 percentage points higher in 2003 than in 1993, which was the highest rise of all eight banks. This deterioration in its cost income ratio was essentially the price Deutsche Bank paid for its aggressive expansion into investment banking and reflected only to a lesser extent potential cost disadvantages from its relative small size.

The different competitive environments are reflected in the varying refinancing conditions in each country. It is a popular argument among German bankers that the state-owned savings banks and the cooperative banks, which are not expected to maximise profits, are responsible for the country's low interest margins. In particular, the state guarantees given to the Landesbanks (state banks of the federal states), through which the savings banks refinance their business by issuing bonds, are considered to have distorted competition.

It is a fact that the four German banks together had an average net interest margin of 1.3% during the period analysed, compared to 2.7% for their British counterparts. Yet it is worth noting that net interest margins in Germany⁴ fell more strongly than in the UK, namely from 1.9% in 1993 to 1.0% in 2003. Despite the consolidation in the UK, the average net interest margin fell from 2.9% in 1993 to 2.5% in 2003. If HSBC, the bank with the least UK exposure, were excluded, then the net interest margin dropped from 2.7% in 1993 (also excluding HSBC) to 2.3% in 2003.

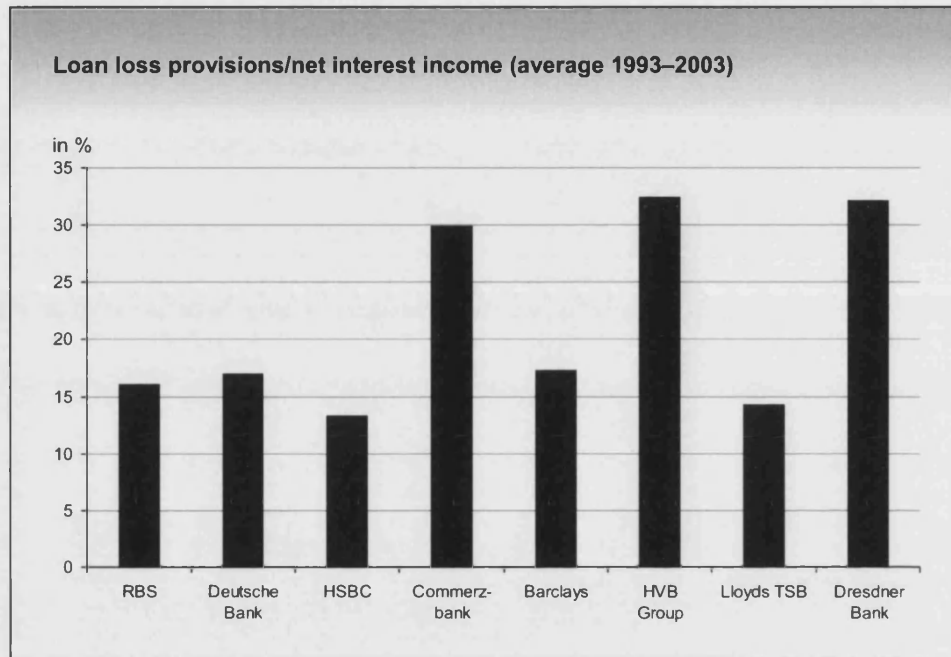


The decline in net interest margins in the UK suggests that disintermediation and the general decline in interest rates and inflation contributed to this development. However, Lloyds TSB's average net interest margin of 3.2%, the highest of all eight banks, is 1 percentage point higher than its UK rival Barclays' net interest margin of 2.2%. Given that these two banks were largely focused on their domestic market this 1 percentage point difference can be ascribed to Lloyds TSB's better refinancing conditions and pricing power – in short, to its better financial strategy.

The distorted competition on the German banking market explains, at least partially, the lower net interest margins. While net interest margins are

⁴ Deutsche Bank's average net interest margin was 1.4%, which was the highest of the four German banks.

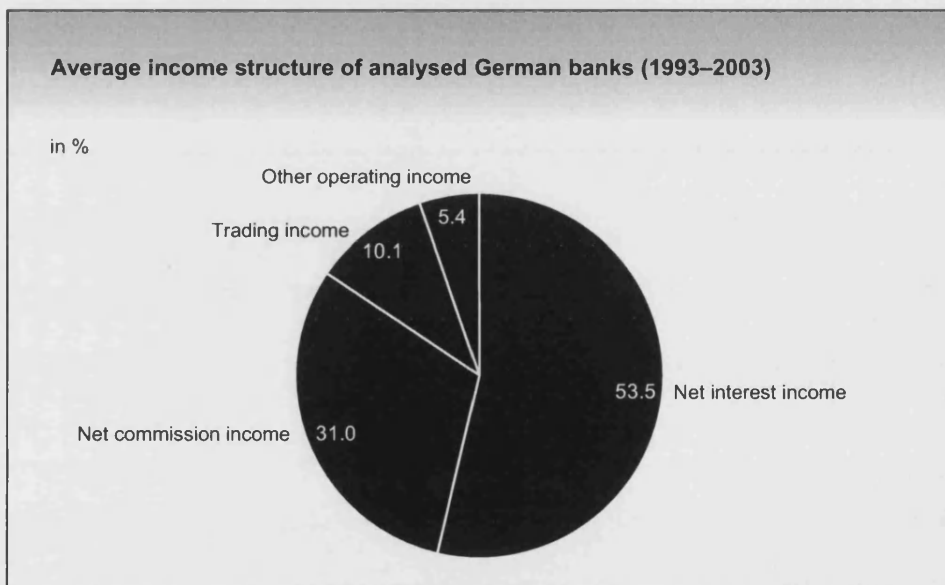
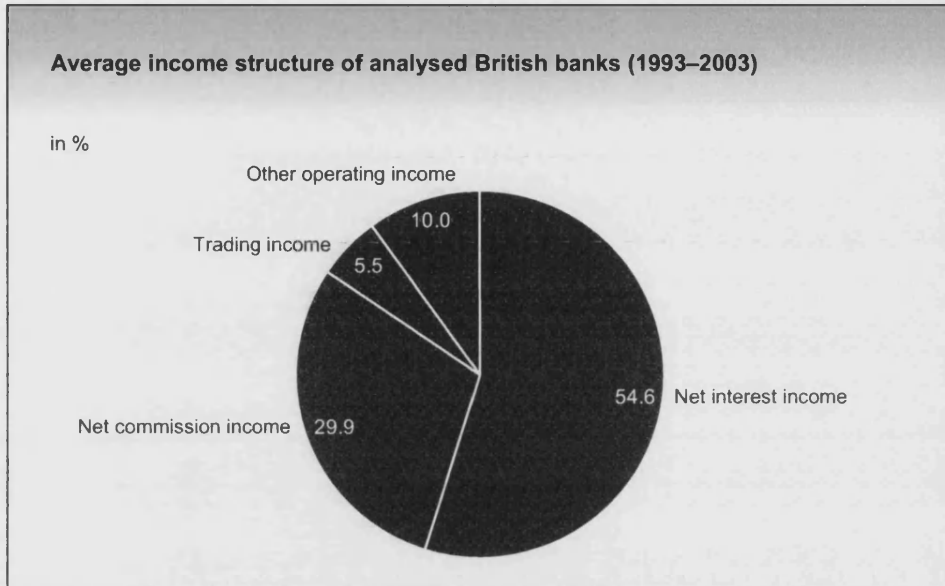
dependent variables of the country's market structure, the ratio of loan loss provisions to net interest income provides an insight into the banks' risk management. The British and German banks show a marked difference in loan loss provisions. On average 28% of the German banks' net interest income was eaten up by loan loss provisions, in contrast to 15% at the four British institutions.



Admittedly, the weaker German economic growth made lending to trouble-free companies more difficult. Yet, a bank's task is to assess correctly the risks of its creditors in stormy times and not just when the weather is fair. Moreover, a significant proportion of loans that went sour were non-German loans and thus independent of Germany's economic situation. The economic developments in Eastern Germany that fell short of many bankers' expectations explain to some extent the need for high loan loss provisions.

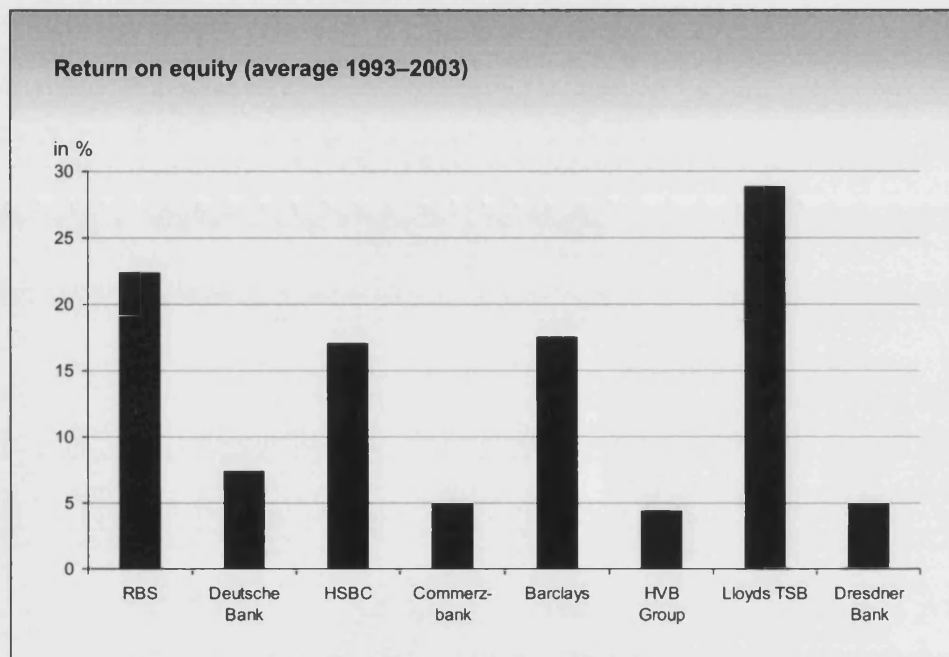
Although, all of these macroeconomic developments are reasonable explanations, they do not justify the weak record in lending. Deutsche Bank's relatively good ratio of loan loss provisions to net interest income of 17% shows that, despite international lending and credit exposure in Eastern Germany, better risk management can make a difference. Overall, the far higher ratio of loan loss provisions to net interest income in Germany resulted

from appalling risk management and a lending policy that was blinded by delusions of grandeur.



Notwithstanding these profound differences between the British and German banks analysed, the aggregate average income structures were much alike. 54% of the German banks' operating income stemmed from net interest income, compared to 55% at the four British banks. Commission income accounted for 31% and 30% of operating income at the German and British banks, respectively. The gap was only wide in trading income and other

operating income. Trading income made up on average 10% of the German banks' operating income, but only 6% at the British institutions. The proportionately higher German trading results were a reflection, above all, of Deutsche Bank's and Dresdner Bank's investment banking activities. The high proportion of other operating income at the British banks, namely 10%, versus 5% at the German banks, reflects the UK players' insurance operations.⁵ With the exception of Barclays, which opted for a strategic alliance in order to offer insurance products, the other three banks had their own insurance arms.



Better risk management, more stringent cost control and higher net interest margins made British banks on average four times more profitable⁶ than their German rivals during the period analysed. Despite the similar income structures, British banks achieved returns on equity between 1993 and 2003 that averaged 21%. This compares to the 5% return on equity that the four German banks delivered on average during the same period. Even without the high losses made by Dresdner Bank, Commerzbank and HVB in 2002 and 2003, the average ROE would have been only 8%. Already in 1993, the average ROE of the four British banks exceeded that of their German counterparts by 7 percentage points.

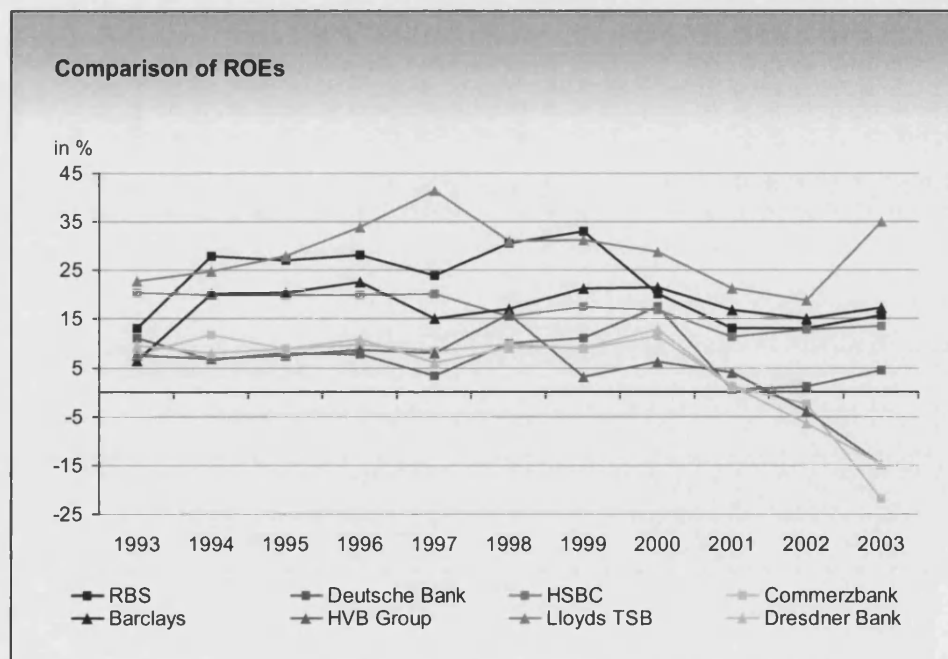
⁵ Insurance premium income was disclosed under "other operating income".

⁶ Profitability measured as return on equity.

6.4. Bridging the micro/macro divide in European economic integration

The discussion of the case studies and the concluding cross-case pattern analysis in the previous two sections provide a basis for answering the question addressed by this research: Why did British and German banking strategies differ, leading to different levels of profitability between 1993 and 2003? Subsequently, this section turns to the part of the research question which addresses the implications of the strategies pursued by British and German banks for European financial integration.

It is argued that the higher returns on equity generated by the British banks compared to their German counterparts came from British bank managers' greater adherence to the shareholder value concept (Llewellyn, 2005). "[...] British banks have been highly profitable partly because they have chosen to be profitable in that, compared with banks in some European countries, they set the ROE as the central and uncompromising business objective. Furthermore, structural factors, and a beneficial business cycle, have been conducive to this" (Llewellyn, 2005, p. 309).



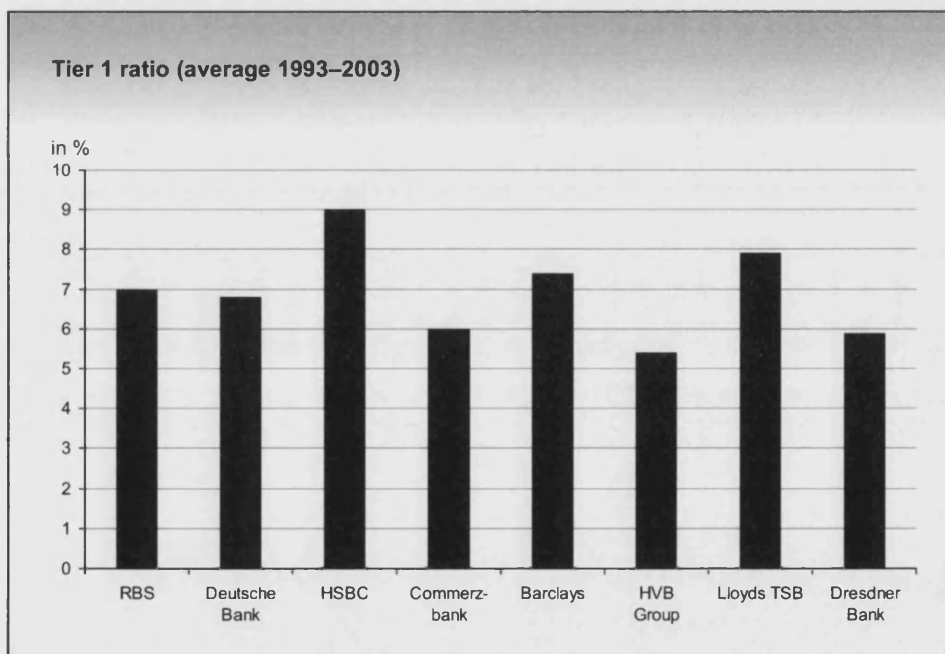
Proponents of the shareholder value approach generally regard the stakeholder value concept as the competing paradigm for managing firms. The stakeholder value approach recognises the multiple interests of a broad range of groups affected by the actions of a firm, including its owners, i.e. the shareholders (Freeman, 1983). It follows that the stakeholder concept is indeed an extension of the narrower shareholder value concept and does not stand in contradiction to it. The large number of state-owned banks and mutual cooperative banks along with the strong representation of employees on the supervisory boards nourished the argument that the German banking system is essentially a stakeholder value oriented system, whereas the UK is predominantly a shareholder value oriented system, and that this difference largely explains the different levels of profitability (Llewellyn, 2005).

Such observations may hold true if one considers how rigorously Lloyds' CEO Brian Pitman applied the ROE criteria when shutting down businesses. The frequent rights issues and the ease with which Commerzbank, among others, high-handedly tapped the capital markets, thereby ignoring any dilutive effects for existing shareholders, supports the view that German banks did not adhere to a shareholder value concept. Yet the general assumption that British bank managers followed a rational shareholder value approach can also be easily shattered, for example, by the statement by Barclays' long-standing chairman, Andrew Buxton, that he would not have cared if Barclays' share price went down a very long way (interview Martin Taylor). Furthermore, it should be remembered that all four German banks analysed here had announced ROE targets by 1994 at the latest.

The three reasons identified by Llewellyn – the shareholder value approach, structure and a benign British business cycle from the early 1990s – were important factors supporting profitability in the UK. Certainly, Britain's capital-market based financial system, with its strong fund management industry, encouraged senior managers at publicly listed banks to give ROE criteria priority in assessing strategic options. However, strictly applying a shareholder value concept implies constraints for corporate strategy. An orthodox shareholder value approach is likely to run counter to business diversification, ruling out exposure to different business cycles and risk structures. Moreover, setting a return on equity target for the whole bank ultimately has implications for each segment. First, internal rivalry about capital allocation arises. Second,

a comparison of segmental ROEs may create tension among the different business segments if their profitability varies significantly, regardless of the actual level of profitability.⁷

The implications of applying a strict ROE approach to managing a bank's strategy became evident in the case of Lloyds TSB. Given the high levels of profitability achieved in its home market, it became increasingly difficult for the bank to expand internationally without diluting its existing business. Thus, the strict application of ROE criteria confined Lloyds TSB to its home market, making it difficult for it to escape from its profitable isolation. The development of Lloyds TSB illustrates how rigorous application of the shareholder value concept may not always be in the best interest of shareholders. What matters to shareholders is stable profit growth, which appears to benefit from a sustainable business model. Shareholders are also proxy entrepreneurs who are willing to accept unknown risks if they could lead to profitable growth.



For example, under stringent ROE criteria RBS would not have provided the seed money for Direct Line, its hugely successful insurance arm. A consistent shareholder value approach at HSBC would have deprived it of becoming a

⁷ A bank is not a homogenous business, but neither is investment banking, retail banking or corporate banking. Arguably, the less knowledgeable the researcher or the observer is, the more homogenous an industry appears to be.

case study for this research, as an investment in the ailing Midland Bank would have been unthinkable for such a highly profitable Hong Kong bank. Further evidence of the limited and inappropriate use of the shareholder value concept is the acquisition of the very profitable investment bank Wasserstein Perella by Dresdner Bank. This move was right insofar as it enhanced ROE, yet Wasserstein Perella disintegrated within a short period after it had been taken over and profits declined.

Notwithstanding the importance of return on equity as the principal criterion for the shareholder value concept, the importance of structure finds insufficient weight in the studies that merely contrast shareholder value and stakeholder value concepts (e.g. Llewellyn, 2005). The distinctive structure of the British banking sector results from the fact that bank managements recognised in the early 1990s that they could change the banking landscape to their advantage through their decisions. For management to recognise this and to act accordingly takes analytical, pragmatic and power-driven bank managers. Consequently, the management of British banks focused on domestic consolidation, expanding scale and streamlining processes. If British banks had slavishly followed the shareholder value concept, they would not have been able to grow their revenues by a CAGR of 14% p.a. over a decade.

Unlike their British counterparts, the management of several German banks found it difficult to accept their path dependency and wanted to switch to a business model that was not compatible with the country's prevailing bank-based financial structure. This was the case at Deutsche Bank, Dresdner Bank and Commerzbank. Deutsche Bank was in the privileged position that it could at least partially overcome the structural forces of the German banking landscape by building up international investment banking expertise, financed by billions of euros of disposal gains from its industrial holdings.

Despite having the same ambitions as Deutsche Bank, Dresdner Bank did not have the same financial cushion. It also had inferior risk management and less stable management. Commerzbank wanted to go down the capital market and investment banking road as well but was simply too slow, which eventually made it easier for management to reverse its strategy. HVB pursued a consolidation strategy that aimed at gaining regional strength. It was therefore the only bank of the four analysed that accepted the structures of the bank-

based German financial system. Yet, this high-sounding strategy did not entail good risk management.

The case studies of HVB and Dresdner Bank, the two banks with the lowest average returns on equity and the weakest capital positions, also brought to light the shortcomings of supervisory boards. The role of a supervisory board is to monitor the work of the management board and to appoint and if necessary dismiss the bank's executives. There seemed very little reaction by the supervisory boards to the fact that both banks consistently missed their targets. Overall, the German corporate governance system showed a great degree of phlegm and indifference towards the activities of the management board.

There appeared little awareness by the supervisory board members that their essential task is to oversee the management board and to make the right personnel decisions. In the UK, the greater professional experience of non-executive directors seems to have nourished an environment in which personnel issues were addressed more openly. For example, Barclays' board showed excellence in appointing the right CEO for each phase in the bank's development. The different corporate governance systems and their impact on the important task of finding the best-suited executive directors would be worth a detailed analysis, but that goes beyond the scope of this thesis.

Finding the leader who is best suited for a particular phase is a soft, but important, factor that set German and British banks apart. A less legalistic and quantitative and more sales and client-oriented understanding of banking contributed to the quality of leadership among British bankers. Thoroughly comprehending the clients' situation and needs also serves as the best initial risk management tool. RBS' US expansion, which followed the maxim "if you cannot drive to it, don't lend to it" is a case in point, illustrating the importance of client proximity as a means of risk management.

Another important reason why British banks fared better in the 1990s is that they had already undergone a tremendous crisis in the 1980s. The learning curve, i.e. collective memory, seemed to have worked to their favour. The 1980s included such incidents as NatWest's Blue Arrow scandal, the crisis at Midland Bank and overly ambitious international expansion by Barclays and

Lloyds that eventually depleted their profitability. The senior managers of the 1990s had lived through the 1980s and seemed to remember and have learnt from that experience.

In addition, Big Bang in 1986 paved the way for greater flexibility. More importantly, Big Bang raised the question of what the British clearing houses should do with regard to disintermediation and transaction services. Overall, the numerous small British merchant banks were too proud to join up with the clearers and did not merge with each other. So the more sales-gifted US investment bankers with their greater experience of the capital markets swiftly moved in. The old clearing houses quickly abandoned any attempts to make inroads into this investment banking business. Instead they focused on the retail client base which they had been familiar with for decades and knew how to serve. The decision to opt for "scale" over "scope" was made and led the way for consolidation of the domestic market.

The presence of US American investment banks in London and the aggressive Japanese banks on the British corporate lending market in the early 1990s helped British banks to focus on retail clients, the last business area which appeared difficult for foreign banks to reach. The strong UK economy provided additional backwind and British consumers and house-owners further accelerated revenue growth. Moreover, the presence of US investment banks on the London market attracted more and more well-qualified bankers to the City. Although most of them stayed within the investment banking world, this still provided an intellectual spill-over effect and enabled, for example, Barclays to develop Barclays Capital under Bob Diamond, an American investment banker and one of the key figures in Barclays Capital's success.

In Germany, banks had not gone through the same traumatic experience as their British counterparts during the 1980s. 1989 brought about the fall of the Berlin Wall, the end of communism and the first signs of globalisation with a sense that a new era was beginning. This created an enthusiasm that quickly turned into euphoria and from there into megalomania and hubris. Against the background of the difficult retail banking market this internationalisation, along with Europeanisation and globalisation, was taken as a reason or excuse to

embark on an internationalisation spree. Moreover, technical innovations added to the range of new opportunities.

From the early 1990s German banks slowly but steadily moved into an opportunity dilemma. Management perceived incessant opportunities that appeared attractive but forgot to prioritise. The banks saw the opportunities but not the opportunity costs that came with them. While a more capital-market or shareholder value oriented approach might not have stopped such projects, it might at least have raised additional questions before some projects were launched.

The findings from the case studies clearly demonstrate that, on the whole, the British banks analysed pursued defensive strategies, in other words they remained focused on the domestic market. For a defensive strategy of this type to be successful, a bank needs assets and capabilities that are specific to the domestic market (Adamides, et al., 2003). For example, a well-established distribution network may help to deter rivals even in industries like banking which have strong globalisation characteristics.

By contrast, German banks, showed a strategic pattern which fully embraced all new opportunities that led to an international multi-business strategy. Yet, the attempt to capture many of the new opportunities that arose in the early 1990s deprived the German banks analysed of their strategic focus and provoked erratic strategy changes. Even in the case of Deutsche Bank, which with hindsight had a coherent strategic reorientation towards international investment banking, there were many “trials and tribulations” as its former CEO Hilmar Kopper conceded in the interview for this research.

Consequently, these German institutions could not develop sufficient power to make inroads into other European countries. Effectively, neither the corporate strategies pursued by British banks, nor those followed by their German counterparts did much to promote European banking integration and thus European financial integration, other than on some wholesale markets. Moreover, none of the banks, with the exception of the hapless HVB, pursued with great rigour a corporate strategy that was tailored towards the enlarged opportunities that opened up after the Single Market had, *de jure*, been completed in 1993.

Indeed, HVB can be identified as the only bank of the eight studied for this thesis with a clearly formulated pan-European strategy targeted at seizing the opportunities of a liberalised market. Ironically, its takeover by the Italian bank Unicredit meant it did actually become one of the few banks to be involved in a large pan-European banking deal – but only as prey. Deutsche Bank's pan-European retail banking endeavours were described as mere trials and tribulations by its former CEO, Hilmar Kopper, as its focus was on international investment banking. Besides some rudimentary European cooperations in the 1970s, any substantial European strategy seemed out of reach for Commerzbank as it was too entangled in its local retail and SME business. Dresdner Bank's talk about being a European, or even a global player could never materialise due to its poor risk and cost management and frequent changes of CEO.

At HSBC, Europe and the liberalised European banking market appear to have played only a subordinate role in the group's overall global multi-local corporate strategy. The acquisition of CCF in France was certainly driven less by a pan-European approach than by the chance of acquiring an established local player with promising prospects on attractive conditions. Lloyds TSB did not "go European" as the expenses for internationalisation would have diluted the high profitability generated by its domestic operations. For similar reasons, and because of the absence of potential scale efficiencies from branching out into other European countries, Barclays remained coy about European banking strategies. In the case of The Royal Bank of Scotland, the period analysed was used to gain size on the British market and to grow beyond its peripheral position, which it primarily achieved through the acquisition of NatWest. Thereafter, The Royal Bank of Scotland promoted its pan-European interests slightly more intensively, but largely via a cautious organic approach focused on commercial and wholesale banking.

Overall, it can be concluded that for economic integration to become effective, market liberalisation on a grand scale is certainly a necessary, but by no means a sufficient condition. Managing economic integration requires a thorough understanding of the interests and capabilities of those players that act on a micro-level, thereby ultimately altering the macro-structures. Opening up new opportunities does not necessarily mean that the newly available

opportunities are also seized (as evidenced by British banks) and if they are exploited, then it is still not certain that the new situation can be successfully managed with the existing set of capabilities (as shown by German banks).

The different outcomes of the strategic reactions of British and German banks identified in this research corroborate the theory that a financial system is a configuration of its subsystems with a coherent structure (Schmidt, 2001). As banks are an integral part of their respective national financial systems, this coherence, which in fact contributes to the stability of a financial system, also poses a challenge for new corporate strategies that are not compatible with the prevailing structure.

Therefore, a stable and coherent financial system with banks forming important institutional pillars is relatively resistant to structural change (Hackethal & Tyrell, 1998; Hackethal & Schmidt, 2000; Schmidt, 2001). This research showed that banks which pursued a defensive strategy, accepting the premises of a coherent financial system, fared better than those that attempted to break out of a coherent structure to pursue strategies not compatible with the overall financial system in their home market.

Studying the corporate strategies of eight large European banks offers an unprecedented understanding about the interdependence of agents and structure of Europe's financial system. In the tradition of Giddens' ontological concept of structuration, this research demonstrates that social action requires structure and that structure is the result of social action. According to structuration, there is an intrinsic interdependence between the micro and macro levels. This interdependence could be shown in the function of banks (representing micro structures) as institutions that determine the macro structure of a financial system.

Applied to the realm of corporate strategy, Giddens' concept of structuration strengthens the argument that strategy cannot be separated from its environment and that the formulation and implementation of strategy are closely intertwined, as a natural consequence of the view of strategy as process (Clausewitz, 1997; Mintzberg et al., 1998). In economic theory, Giddens' concept of structuration finds its parallels in the structure-conduct-performance paradigm (SCP), as discussed in chapter four (Mason, 1939,

1949; Bain, 1951, 1956, 1959). The SCP paradigm recognises the link between industry structure and the conduct of the firms that comprise an industry. This research made use of the SCP paradigm through Porter's more specific five forces framework modified for the banking industry.

The importance of power in Giddens' concept of structuration also complements the understanding of strategy as a process. The relative power of actors becomes pivotal for the interdependence between agent and structure. An actor's ability to alter the prevailing structure depends upon its resources and positioning, and thus its power within the structure. This reasoning appears consistent with Schmidt's previously elaborated argument that a financial system is a configuration of its subsystems, which complement each other, and that the coherence of such a system renders it resistant to structural change (Hackethal & Schmidt, 2000; Schmidt, 2001).

In order to overcome systemic rigidity, a few actors need to become sufficiently powerful to change the structure to meet their interests. The findings from the case studies brought to light that this is precisely what did not happen in Germany, whereas as it drove the consolidation process in British banking between 1993 and 2003. As the analysed four British banks gained more power relative to the other actors that made up the structure, they attained an even more favourable position that enabled them to achieve further changes. It can be concluded that the more consolidated a banking market, the easier it is for the players to change the structure.

Moreover, applying Giddens' concept of structuration as a methodological framework also pays adequate attention to the unintended implications that one level has on the other. The slow progress of banking integration in Europe between 1993 and 2003, which fell short of the expectations at the beginning of the common market, strengthens the argument that the interdependence between actors and structure should be given greater prominence in international relations and socio-economic research projects. Merely liberalising markets and harmonising the laws of European nations is evidently not enough to stimulate European integration.

Therefore, the findings of this research are also a profound criticism of Cecchini's model and other approaches taken by the European Commission

to evaluate the implications of their policies prior to launching the Single Market Programme. Cecchini's model primarily considered the opportunities of economic integration and did not sufficiently consider the large players' strategic reactions to market liberalisation. From this research it may be concluded that European policy-makers do not adequately take into account the interdependence of agents and structure. Their focus appears either too narrow - on the micro level (agent) - or too general - on the macro level (structure), ultimately fostering structural inertia.

6.5. Methodological limitations and suggestions for future research

The more knowledge is generated, the more questions arise. Insofar, this research probably raises more questions than it answers, especially as it is the first longitudinal cross-country multi-case study of the banking sector. It offers an answer to the question as to why British and German banking strategies differed substantially during the decade after the beginning of the Single European Market. By answering that question, it has also shown why the four British banks analysed were on average four times more profitable than their German counterparts. Moreover, it has explained why none of the strategies pursued by German and British banks ultimately enhanced European banking integration. What follows are recommendations for further research projects, which at the same time pinpoint the principal limitations of this research.

One question that emerged as an increasingly obvious problem as this research progressed was the different corporate governance systems in Germany and the UK. More specifically, how did the different corporate governance systems in Britain and Germany affect decisions about the banks' leadership, strategy, risk and capital management? Corporate governance issues, as the pinnacle of the principal-agent problem, will remain a pressing issue in Germany and the UK and should be thoroughly researched.

Besides identifying specific strategic sub-themes, such as the corporate governance issue, complementary research could investigate the strategy-making process at each bank. It is likely that not more than one bank per thesis would be feasible as - in contrast to the approach used here - such an undertaking would require hundreds of interviews. The purpose of such an investigation would be to address important socio-psychological questions in the tradition of Henry Mintzberg: how do certain strategies emerge over time and how are ideas promoted and finally implemented?

Further complementary research could take the form of single in-depth case studies, using the same theoretical framework as this research. With the focus on just one bank, such an approach would require the full support of the bank,

ideally fully backed by the management. A bank willing to accept an in-depth strategy analysis of its recent past could greatly benefit from it. Management could sharpen its awareness of past successes and shortcomings and more clearly see the strengths and weaknesses of its current position. Moreover, such an in-depth case study could feed into the bank's risk management system as it could also help to deal with the institutional memory problem. Additional research projects using the same method should perhaps consider different and/or more countries - e.g. Italy, France, Spain (as interesting European banking markets) - longer periods, and other financial services firms, for example, the insurance sector. These analyses could also take the form of a game theory model, studying agent-structure interdependence in banking with quantitative tools.

6.6. Epilogue – daring an outlook

This research focused on the period stretching from 1993 to 2003. For three reasons it appeared pertinent to analyse this decade. First, in 1993 the Single Market Programme (SMP) was completed. This triggered wide-ranging changes in the financial services industry in the following years. Second, it takes several years for strategic adjustments to be implemented at large financial institutions and to show results. Third, the time between 1993 and 2003 spans one full business cycle in Britain and Germany. Moreover, for pragmatic reasons there had to be a cut-off date for the case studies, as otherwise this would have become a perpetual task. Between the cut-off date at the end of 2003 and summer 2007, when this research project was completed, the European banking landscape continued to evolve.

After 2003, streamlining and efficiency programmes remained high on the agenda at British banks. More widespread use of a wide variety of technological innovations has led to signs of increasing industrialisation in banking, especially retail banking. The strong economic growth that has continued until the present day in the UK has provided further tailwind for British banks' profitability. In fact, without any notable new entrants thwarting the banks' comfortable market position, the degree of market concentration has actually increased. Thus, the dependence on the British economy has become one of the greatest risk factors for some of the banks analysed in this research. In the light of the highly concentrated domestic market, British banks have begun to seek again international growth opportunities, with the European continent seemingly being given the same consideration as any other part of the world.

German banks have recovered from their experiences in 2002/03, which was the severest crisis in the German banking sector since the end of World War II and nearly wiped out some of the country's financial institutions. Continued restructuring has taken the form of stringent cost control, improved risk management, more client-oriented sales approaches and, most importantly, a greater awareness of the importance of not wanting to be involved in all aspects of the value chain. Notwithstanding the progress made by adopting more focused strategies, the structure of the German banking market has not

changed substantially. The three-pillar structure remains the dominant characteristic of German banking and still impedes mergers between savings banks, cooperative banks and the private sector banks. Operating in a highly fragmented domestic market, none of the German banks has gained such a position that a large scale international expansion seems imminent.

While the structure of the German market allows mergers and acquisitions to take place only within each pillar of the banking sector, in most other European countries consolidation has continued, albeit at a slow pace and within national borders. Cross-border mergers remained the exception rather than the rule until summer 2007, when Barclays and The Royal Bank of Scotland were battling for control of the Dutch bank ABN AMRO in what would be the largest ever takeover in Europe. It is obvious that, given the limited scope for domestic market expansion in many European countries, except for Germany, banks are likely to look abroad for growth opportunities.

Although national banking systems clearly prevail some 14 years after the Single Market Programme was completed, the relentless growth of the internet and cheaper international phone calls have facilitated both corporate and retail clients' cross-border access to a full range of banking services. Despite growing demand for international direct distribution, this trend, which is still emerging, is only likely to affect standard financial products and simple banking services.

As long as national discrepancies in taxation, consumer protection, contract law and financial regulation persist, especially in retail banking, full harmonisation of the market entails overcoming very high hurdles. Greater use of new technologies is probably reducing the significance of local branches for standardised products and transactions. Thus, personal financial advice will become even more detached from the manufacture of everyday financial products. Already visible in personal finance, this unbundling of distribution and production is likely to be applied to institutional/corporate customers as well.

Alongside a few financial services conglomerates with excellent risk management, financial services firms that focus on a few aspects of the unbundled banking and insurance market are likely to emerge. Restructuring

6. Conclusions

the value chain in financial services will allow small players to occupy niches in an industry that is undergoing structural upheaval. Over time, some players may not be able to resist the temptation to expand into other areas of the market, and could eventually become major financial institutions by the end of the 21st century. In the meantime, however, it is hard to overcome the inertia of long-established national financial structures merely by liberalising markets and harmonising laws. If anything, this research has shown that for a macro project, such as European economic integration, to succeed it must be implemented at the micro level by those agents, who give life to structures simply by using them.

Bibliography & Sources

A) Books

1. Ackrill, M. & Hannah, L. (2001) *Barclays: The Business of Banking, 1690-1996*. Cambridge: Cambridge University Press.
2. Allen, F. & Gale, D. (2000). *Comparing Financial Systems*. Cambridge, MA: MIT Press.
3. Altunbas, Y. & Molyneux, P. (2001). Technical change in European banking. In Gardener, E.P.M. & Versluijs, P.C. (eds.) (2001). *Bank strategies and challenges in the new Europe*. Basingstoke: Palgrave.
4. Ansoff, H.I. (1965). *Corporate Strategy*. New York, NY: McGraw-Hill.
5. Ansoff, H.I. (1987). *Corporate Strategy*. New York, NY: McGraw-Hill.
6. Artis, M. & Nixon, F. (eds.) (2001). *The Economics of the European Union - Policy and Analysis*. 3rd ed. Oxford: Oxford University Press.
7. Artis, M. (ed.) (1992). *Prest & Coppock's - The UK Economy*. 13th ed. Oxford: Oxford University Press.
8. Baethge, M., Kitay, J. & Regini, M. (1999). *From Tellers to Sellers - Changing Employment Relations in Banks*. Cambridge, MA: The MIT Press.
9. Bain, J.S. (1956). *Barriers to New Competition*. Cambridge, MA: Harvard University Press.
10. Bain, J.S. (1959). *Industrial Organisation*. New York: John Wiley & Sons.
11. Bain, K. & Howells, P. (2000). *Financial Markets and Institutions*. Harlow: Financial Times Prentice Hall.
12. Bain, K. & Howells, P. (2002). *The Economics of Money, Banking and Finance*. Harlow: Financial Times Prentice Hall.
13. Balassa, B. (1961). *The theory of economic integration*. London: Allen and Unwin.
14. Balassa, B. (1991). *Economic Integration*. In: Eatwell, R. et al. (eds.) (1991). *The World of Economics*. London: Macmillan.
15. Ballarin, E. (1986). *Commercial Banks and the Financial Revolution*. Cambridge, MA: Ballinger Publishing Company.
16. Beer, S. (1966). *Decision and control. The Meaning of Operational Research and Management Cybernetics*. Chichester: Wiley.
17. Beer, S. (1981). *Brain of the Firm*. Chichester: Wiley.
18. Berger, P.L. & Luckman, T. (1966). *The Social Construction of Reality*. London: Penguin.
19. Betge (1996). *Bankbetriebslehre*. Berlin: Springer Verlag.

20. Birkefeld, S. (1997). Mit voller Kraft ins Ungewisse. Der Geschäftsaufbau der Dresdner Bank AG in den fünf Neuen Bundesländern. Dresden: Sandstein.
21. Black, J. (1997). Dictionary of Economics. Oxford: Oxford University Press.
22. Bodie, Z. & Merton, R.C. (1995). A conceptual framework for analysing the financial environment. In Crane, D.W. (1995). The Global Financial System - a functional perspective. (1995). Boston: Harvard Business School Press.
23. Börner, C.J. (2000). Strategisches Bankmanagement. Munich: Oldenbourg.
24. Brandenburger, A.M. & Nalebuff, B.J. (1996). Co-opetition. New York: Doubleday.
25. Buch, C.M. & Lapp, S. (2000). Bank Portfolios in Euroland. In Moser, T. & Schips, B. (eds.). EMU, Financial Markets, and the World Economy. Boston: Kluwer Academic Publishers.
26. Buckle, M. & Thompson, J. (2004). The UK financial system. Manchester: Manchester University Press.
27. Burda, M. & Wyplosz, C. (1993). Macroeconomics - A European Text. Oxford: Oxford University Press.
28. Büschgen, H.E. & Börner, C.J. (2003). Bankbetriebslehre. Stuttgart: Lucius & Lucius.
29. Büschgen, H.E. (1993). Bankbetriebslehre. 4th ed. Wiesbaden: Gabler.
30. Büschgen, H.E. (1998). Bankbetriebslehre. 5th ed. Wiesbaden: Gabler.
31. Campbell, A. & Goold, M. (1987). Strategies and Style. Oxford: Blackwell.
32. Campbell, A. & Yeung, S. (1990). Do you need a mission statement? Special Report No. 1208. London: The Economist Publications Management.
33. Campbell, A. & Luchs, K.S. (1992). Strategic Synergy. Oxford: Butterworth-Heinemann.
34. Canals, J. (1993). Competitive Strategies in European Banking. Oxford: Oxford University Press.
35. Canals, J. (1997). Universal Banking. Oxford: Oxford University Press.
36. Carmoy, H. de (1990). Global Banking Strategy: financial markets and industrial decay. Oxford: Basil Blackwell.
37. Cecchini, P. (1988). The European Challenge 1992: the benefits of a single market. Aldershot: Wildwood House.
38. Chalmers, A.F. (1982). What is this thing called Science? Milton Keynes: Open University Press.

39. Chandler, A.D. (1962). *Strategy and Structure*. Cambridge, MA: MIT Press.
40. Chandler, A.D. (1977). *The Visible Hand*. Cambridge, MA: Harvard University Press.
41. Channon, D.F. (1986). *Cases in Bank Strategic Management and Marketing*. Chichester: Wiley.
42. Channon, D.F. (1988). *Global Banking Strategy*. Chichester: Wiley.
43. Chapman, S. (1984). *The Rise of Merchant Banking*. London: George Allen & Unwin.
44. Checkland, S.G. (1975). *Scottish Banking. A history, 1695-1973*. Glasgow: Collins.
45. Clausewitz, C. von (1997). *On War*. Translated by Graham, J.J. Ware, Hertfordshire: Wordsworth Editions.
46. Collins, H.M. (1983). An empirical relativist programme in the sociology of scientific knowledge. In Knorr-Cetina, K.D. & Mulkay, M. (eds.) (1983). *Science Observed: Perspectives on the Social Study of Science*. London: Sage.
47. Creemers, M.R. (2001). Dimensions of actions distribution. In Gardener, E.P.M. & Versluijs, P.C. (eds.) (2001). *Bank strategies and challenges in the new Europe*. Basingstoke: Palgrave.
48. Cressey, P., Eldridge, J. & MacInnes, J. (1985). *'Just Managing': Authority and Democracy in Industry*. Milton Keynes: Open University Press.
49. Crotty, M. (1998). *The foundations of social research: meaning and perspective in the research process*. London: Sage.
50. Cyert, R.M. & March, J.G. (1963). *A behavioural theory of the firm*. Englewood Cliffs, NJ: Prentice-Hall.
51. Dale, R. (1992). *International Banking Deregulation*. Oxford: Blackwell.
52. Dale, R. (1996). *Risk and Regulation in Global Securities Markets*. Chichester: John Wiley & Sons.
53. Damodaran, A. (2002). *Investment Valuation - tools and techniques for determining the value of any asset (University Edition)*. New York: Wiley.
54. Dannenberg, M. (2001). *Strategisches Bankmanagement. Die Bewältigung von Komplexität, Dynamik und Unsicherheit im Kreditgewerbe*. Wiesbaden: Deutscher Universitäts-Verlag.
55. Davis, E.P. (1995). *Pension Funds, Retirement-Income Security and Capital Markets, an International Perspective*. Oxford: Oxford University Press.
56. Denscombe, M. (2003). *The good research guide*. Maidenhead: Open University Press.

57. Denzin, N.K. & Lincoln, Y.S. (1994). Introduction: Entering the field of qualitative research. In: Denzin, N.K. & Lincoln, Y.S., (eds.) (1994). *Handbook of Qualitative Research*. London: Sage Publications.
58. *Dictionary of Finance and Banking* (1997). Oxford: Oxford University Press.
59. Dixit, A.K. & Nalebuff, B.J. (1991). *Thinking strategically: The competitive edge in business, politics and everyday life*. New York, NY: W.W. Norton.
60. Dixon, R. (1993). *Banking in Europe - The Single Market*. London: Routledge.
61. Drucker, P.F. (1974). *Management: Tasks, Responsibilities, Practices*. New York, NY: Harper & Row.
62. *Duden Band 7* (1963). *Etymologie - Herkunftswörterbuch der deutschen Sprache*. Mannheim: Dudenverlag.
63. Dufey, G. & Giddy, I.H. (1978). Financial centres and external financial markets. In: *The International Money Market*. Englewood Cliffs, NJ: Prentice-Hall.
64. Easterby-Smith, M. et al. (2002). *Management Research - An Introduction*. London: Sage Publications.
65. Easterby-Smith, M., Thorpe, R., & Lowe, A. (2001). *Management Research: An Introduction*. London: Sage Publications.
66. Eccles, R.G. & Nohria, N. (1992). Strategy as a language Game. In: Segal-Horn, S. (ed.) (1998). *The Strategy Reader* (1998). Milton Keynes: Blackwell Publishing.
67. Edwards, J. & Fischer, K. (1994). *Banks, finance and investments in Germany*. Cambridge: Cambridge University Press.
68. Eijffinger, S.C.W. & de Haan, J. (2000). *European Monetary and Fiscal Policy*. Oxford: Oxford University Press.
69. Endlich, L. (1999). *Goldman Sachs. The Culture of Success*. New York: Alfred A. Knopf.
70. Espejo, R. & Harnden, R. (eds.) (1989). *The Viable System Model. Interpretations and Applications of Stafford Beer's VSM*. Chichester: Wiley.
71. Espejo, R. & Schuhmann, W. & Schwaninger, M. & Bilello, U. (1996). *Organizational Transformation and Learning. A Cybernetic Approach to Management*. Chichester: Wiley.
72. Espejo, R. & Schwaninger, M. (eds.) (1993). *Organisational Fitness - Corporate Effectiveness through Management Cybernetics (with contributions by Stafford Beer and others)*. Frankfurt/New York: Campus.
73. Etzioni, A. (1965). *Political Unification: A Comparative Study of Leaders and Forces*. New York, NY: Holt, Reinhardt and Winston.

74. Fabozzi, F.J. (2000). *Bond Markets: analysis and strategies*. New Jersey: Prentice Hall.
75. Falzon, J. (2001). Characteristics of international financial centres. In Gardener, E.P.M. & Versluijs, P.C. (eds.) (2001). *Bank strategies and challenges in the new Europe*. Basingstoke: Palgrave.
76. Felderer, B. & Homburg, S. (1991). *Makroökonomik und neue Makroökonomik*. Berlin: Springer-Verlag.
77. Feyerabend, P. (1975). *Against Method: Outline of an Anarchistic Theory of Knowledge*. London: New Left Books.
78. Fielding, N.G. & Fielding, J.L. (1986). *Linking Data*. London: Sage.
79. Freeman, R.E. (1983). *Strategic Management*. London: Financial Times Prentice Hall (Pitman Series).
80. Freixas, X. & Rochet, J.-C. (1997). *Microeconomics of Banking*. Cambridge, MA: The MIT Press.
81. Gall, L. et al. (1995). *The Deutsche Bank 1870-1995*. London: Weidenfeld & Nicolson.
82. Gardener, E.P.M. & Molyneux, P. (1993). *Changes in Western European banking - An international banker's guide*. London: Routledge.
83. Gardener, E.P.M. & Versluijs, P.C. (eds.) (2001). *Bank strategies and challenges in the new Europe*. Basingstoke: Palgrave.
84. Gardener, E.P.M. (1990). Financial Conglomeration: A new challenge for banking. In Gardener, E.P.M. (ed.) (1990). *The Future of Financial Systems and Services*. Basingstoke: Macmillan Press.
85. Giddens, A. (1976). *New Rules of Sociological Method*. London: Hutchinson.
86. Giddens, A. (1979). *Central Problems in Social Theory: Action, Structure and Contradiction in Social Analysis*. London: Macmillan.
87. Giddens, A. (1984). *The Constitution of Society - Outline of the Theory of Structuration*. Cambridge: Polity Press; Berkeley: University of California Press.
88. Giddens, A. (1988). *Sociology*. Cambridge: Polity Press; New York: Norton.
89. Glaser, B. & Strauss, A. (1967). *The discovery of grounded theory*. Chicago, IL: Aldine.
90. Goddard, J.A., Molyneux, P. & Wilson, J.O.S. (2001). *European Banking: Efficiency, Technology and Growth*. Chichester: John Wiley.
91. Goldschmidt, G. (1960). Die griechischen Taktiker. In Hahlweg, W. (ed.). *Klassiker der Kriegskunst*. Darmstadt: Wehr und Wissen Verlagsgesellschaft mbH.
92. Goldsmith, R.W. (1969). *Financial Structure and Development*. New

Haven, CT: Yale University Press.

93. Golin, J. (2001). *The Bank Credit Analysis Handbook*. Singapore: Wiley Finance.
94. Goodhart, C.; et al. (1998). *Financial Regulation: Why, How and Where Now?* London: Routledge.
95. Grant, R.M. (1992). Diversification in the financial services industry. pp. 203-242. In Campbell, A., & Luchs, K.S. (1992). *Strategic Synergy*. Oxford: Butterworth-Heinemann.
96. Grant, R.M. (2002). *Contemporary Strategy Analysis - Concepts, Techniques, Applications*. Oxford: Blackwell.
97. Grant, R.M. (2002). *Contemporary Strategy Analysis*. Oxford: Blackwell.
98. Haas, E.B. (1958). *The Uniting of Europe: Political, Social, and Economic Forces, 1950-1957*. Stanford: Stanford University Press.
99. Hartmann-Wendels, T. et al. (2000). *Bankbetriebslehre*. Berlin: Springer Verlag.
100. Heinemann, F. & Jopp, M. (2002). *The Benefits of a Working European Retail Market for Financial Services*. Bonn: Europa Union Verlag.
101. Hempel, G.H. & Simonson, D.G. (1999). *Bank Management*. Chichester: Wiley.
102. Henderson, B.D. (1984). *The Logic of Business Strategy*. Cambridge, MA: Ballinger.
103. Henderson, R. (1993). *European Finance*. London: McGraw-Hill Book Company.
104. Henke, K.-D. (ed.) (2006). *Die Dresdner Bank im Dritten Reich*. Munich: R. Oldenbourg.
105. Hitris, T. (2002). *European Union Economics*. London: FT Prentice Hall.
106. Hofstede, G. (1980). *Culture's consequences*. Beverly Hills, CA: Sage.
107. Holmes, A.R. & Green, E. (1986). *Midland: 150 Years of Banking History*. London: Batsford.
108. Jenkinson, H. (1922). *A Manual of Archive Administration*. Oxford: Percy Lund, Humphries.
109. Katz, M.L. & Rosen, H.S. (1994). *Microeconomics*. Burr Ridge: Irwin.
110. Kenyon, A. & Mathur, S. (1997). *Creating Value: Shaping Tomorrow's Business*. Oxford: Butterworth-Heinemann.
111. Kheng-Hor, K. (1997). *Sun Tzu's Art of War: War at Work: Applying Sun Tzu's Art of War in Today's Business World*. Weatherhill.
112. King, F.H.H. (ed.) (1983). *Eastern Banking: Essays in the History of The Hongkong and Shanghai Banking Corporation*. London: Athlone Press.

113. King, F.H.H. et al (1987-91). *The History of The Hongkong and Shanghai Banking Corporation*, 4 volumes. Cambridge: Cambridge University Press.
114. Kirschen, E. (1969). *Financial Integration on Western Europe*. New York, NY: Columbia University Press.
115. Koch, T.W. & MacDonald, S.S. (2003). *Bank Management*. Mason, Ohio: Thomson South-Western.
116. Koch, T.W. (1995). *Bank Management*. Fort Worth: Dryden Press.
117. Kremers, J. (ed.) et al. (2003). *Financial Supervision in Europe*. Cheltenham: Edward Elgar Publishing.
118. Kundish, D. (2003). *New Strategies for Financial Services Firms - the Life-Cycle-Solution Approach*. Heidelberg: Physica-Verlag.
119. Lane, M. (ed.) (2002). *Alternative Risk Strategies*. London: Risk Books.
120. Lawrence, P.R. & Lorsch, J.W. (1967). *Organization and Environment*. Boston: Harvard Business School.
121. Leahy, G. (ed.) (1997). *Managing banking relationships*. Cambridge: Woodhead Publishing.
122. Ledeen, M.A. (2000). *Machiavelli on Modern Leadership*. New York, NY: St. Martin's Press.
123. Lemmen, J. (1998). *Integrating Financial Markets in the European Union*. Cheltenham and Northampton: Edward Elgar.
124. Liddell Hart, B.H. (1991). *Strategy*. New York, NY: Meridian.
125. Lindberg, L. (1963). *The Political Dynamics of European Economic Integration*. Stanford, CA: Stanford University Press.
126. Lindblom, C.E. & Cohen, D.K. (1979). *Usable Knowledge: Social Science and Social Problem Solving*. New Haven, CT: Yale University Press.
127. Lindblom, C.E. (1968). *The Policy-Making Process*. Englewood Cliffs, NJ: Prentice-Hall.
128. Lindblom, C.E. & Woodhouse, E.J. (1993). *The Policy-Making Process*. Englewood Cliffs, NJ: Prentice-Hall.
129. Herbst, L. u. Weihe, T. (eds.) (2004). *Die Commerzbank und die Juden 1933-1945*. Munich: Verlag C.H. Beck.
130. Macmillan, I.C. & Guth, W.D. (1985). *Strategy Implementation and Middle Management Coalitions*. In Lamb, R. & Shrivastava, P. (eds.) (1985). *Advances in Strategic Management*, Vol. 3. Greenwich, CT: JAI Press.
131. Macmillan, I.C. (1978). *Strategy Formulation: Political Concepts*. St. Paul: West.
132. Magee, B. (1985). *Popper*. London: Fontana Press.

133. Malik, F. (2001). *Management Perspektiven*. Bern: Haupt Verlag.
134. Mastropasqua, S. (1978). *The banking System in the Countries of the EEC: Institutional and Structural Aspects*. The Netherlands: Sijthoff & Noordhoff International Publishers.
135. Mayes, D.G. (ed.) (1991). *The European Challenge: Industry's response to the 1992 programme*. Hemel Hempstead: Harvester Wheatsheaf.
136. Michaelson, G.A. (2001). *Sun Tzu: The Art of War for Managers*. Avon MA: Adams Media Corporation.
137. Miles, N.B. & Huberman, A.M. (1984). *Qualitative Data Analysis: A Sourcebook of New Methods*. London: Sage.
138. Miller, D. (ed.) (1985). *Popper Selections*. Princeton, NJ: Princeton University Press.
139. Milward, A. S. (1992). *The European Rescue of the Nation-State*. Berkeley, CA: University of California Press.
140. Mintzberg, H. (1994). *The Fall and Rise of Strategic Planning*. New York, NY: Free Press.
141. Mintzberg, H. et al. (1998). *Strategy Safari*. London: FT Prentice Hall.
142. Mishkin, F.S. (1986). *The Economics of Money, Banking, and Financial Markets*. Boston, MA: Little, Brown and Company.
143. Molyneux, P., Altunbas, Y., & Gardener, E. (1996). *Efficiency in European Banking*. Chichester: Wiley.
144. Montanaro, E. et al. (2001). *The unified European banking market and the convergence of national banking sectors*. In Gardener, E.P.M. & Versluijs, P.C. (eds.) (2001). *Bank strategies and challenges in the new Europe*. Basingstoke: Palgrave.
145. Monti, M. (1996). *The Single Market and Tomorrow's Europe - A Progress Report from the European Commission*. London: Kogan Page Publishers.
146. Morgenstern, O. & von Newmann, J. (1944). *Theory of Games and Economic Behavior*. Princeton, NJ: Princeton University Press.
147. Mura, J. (ed.) (1996). *History of European savings banks*. Stuttgart: Deutscher Sparkassenverlag.
148. Nalebuff, B. (1996). *Co-opetition*. Presentation Version 5/7/96. Yale School of Management New Haven, CT.
149. Narayanan, V.K. & Fahey, L. (2001). *Macroenvironmental Analysis: Understanding the Environment Outside the Industry*. In Fahey, L. & Randall, R.M. (ed.) (2001). *The Portable MBA in Strategy*. New York, NY: Wiley.
150. Nelson R.R. & Winter S.G. (1982). *An evolutionary theory of economic change*. Cambridge, MA: Harvard University Press.

151. Neven, D.J. (1990). Structural adjustment in European retail banking: some views from industrial organisation. In Dermine, J. (ed.) (1990). European banking in the 1990s. Oxford: Blackwell.
152. Ohmae, K. (1983). The Mind of the Strategist. Harmondsworth: Penguin.
153. Oxford Dictionary of Finance and Banking (1997). Oxford: Oxford University Press.
154. Pelkmans, J. (2001). European Integration - Methods and Economic Analysis. Harlow: Pearson Education.
155. Pettigrew, A.M. (1973). The Politics of Organizational Decision-Making. London: Tavistock.
156. Pettigrew, A.M. (1985). The Awakening Giant: Continuity and Change in Imperial Chemical Industries. Oxford: Basil Blackwell.
157. Pfeffer, J. & Salancik, G.R. (1978). The External Control of Organizations: A Resource Dependence Perspective. New York, NY: Harper Row.
158. Pfeffer, J. (1982). Organizations and organization theory. Marshfield, MA: Pitman.
159. Pohl, M. & Burk, K. (1998). Deutsche Bank in London 1873-1998. Munich: Piper Verlag.
160. Pohl, M. & Freitag, S. (1994). Handbook on the history of European banks. Aldershot: Edward Elgar.
161. Popper, K.R. (1960). The Growth of Scientific Knowledge. In: Miller, D. (ed.) (1985). Popper Selections. Princeton, NJ: Princeton University Press.
162. Popper, K.R. (1960). The Poverty of Historicism. London: Routledge.
163. Popper, K.R. (1979). Objective Knowledge - An Evolutionary Approach. Oxford: Oxford University Press.
164. Popper, K.R. (1985). Popper Selections - Miller (ed.). Princeton, NJ: Princeton University Press.
165. Popper, K.R. (1989). Conjectures and Refutations - The Growth of Scientific Knowledge. London: Routledge.
166. Porter, M.E. (1980). Competitive Strategy. New York, NY: The Free Press.
167. Porter, M.E. (1998). Competitive Strategy. New York, NY: The Free Press.
168. Porter, M.E. (1985). Competitive Advantage. New York, NY: The Free Press.
169. Porter, M.E. (1990). The Competitive Advantage of Nations. New York, NY: Free Press.

170. Quinn, J.B. (1980a). *Strategies for Change: Logical Incrementalism*. Homewood, IL: Irwin.
171. Reason, P. (1988). *Human Inquiry in Action*, London: Sage.
172. Reszat, B. (2005). *European Financial Systems in the Global Economy*. Chichester: Wiley.
173. Rogers, D. (1999). *The big four British banks - organisation, strategy and the future*. London: Macmillan Press.
174. Rose, P.S. & Hudgins, S.C. (2005). *Bank Management & Financial Services*. New York, NY: McGraw-Hill.
175. Rumelt, R.P. (1998). How much does Industry matter? In: Segal-Horn, S. (ed.) (1998). *The Strategy Reader*. Milton Keynes: Blackwell Publishing.
176. Rumelt, R.P.; Schendel, D.E. & Teece, D.J. (1994). *Fundamental Issues in Strategy: a research agenda*. Boston, MA: Harvard Business School Press.
177. Saunders, A. (1997). *Financial Institutions Management - A modern Perspective*. Chicago, IL: McGraw-Hill.
178. Savile, R. (1996). *Bank of Scotland 1695-1995: A History*. Edinburgh: Edinburgh University Press.
179. Sayers, R.S. (1957). *Lloyds Bank in the History of British Banking*. Oxford: Oxford University Press.
180. Scherer, F.M. & Ross, D. (1990). *Industrial Market Structure and Economic Performance*. Boston, MA: Houghton Mifflin Company.
181. Segal-Horn, S. (1998). Introduction. In: Segal-Horn, S. (ed.) (1998). *The Strategy Reader*. Milton Keynes: Blackwell Publishing.
182. Selznick, P. (1957). *Leadership in Administration: A Sociological Interpretation*. Evanston, IL: Row, Peterson.
183. Senger, von, H. (2002). *Die Kunst der List - Strategeme durchschauen und anwenden*. Munich: Beck.
184. Shaw, R. (2001). The bank is dead, long live the bank. In Gardener, E.P.M. & Versluijs, P.C. (eds.) (2001). *Bank strategies and challenges in the new Europe*. Basingstoke: Palgrave.
185. Simon, H.A. (1957). *Administrative Behaviour*. New York, NY: Macmillan.
186. Sloan, A.P. (1963). *My Years with General Motors*. London: Sedgwick & Jackson.
187. Smith, R.C. & Walter, I. (1997). *Global Banking*. Oxford: Oxford University Press.
188. Smith, R.C. & Walter, I. (2000). *High Finance in the Euro-Zone*. Harlow: Financial Times/Prentice Hall.

189. Smith, R.C. & Walter, I. (2003). *Global Banking*. Oxford: Oxford University Press.
190. Stahel, A.A. (2003). *Klassiker der Strategie - eine Bewertung*. Zurich: vdf Hochschulverlag.
191. Starbuck, W.H. (1965). *Organizational Growth and Development*. In March, J.G. (ed.) (1965). *Handbook of Organizations*. Chicago, IL: Rand McNally.
192. Stechow, F. von (1973). *Die Auflösung der Arbeitsteilung im englischen Bankensystem - dargestellt am Beispiel der der Londoner Clearing Banks und Merchant Banks*. Würzburg: Physica Verlag.
193. Steffens, G.Z. (1990). *Die Finanzmärkte in Großbritannien: Neuere Entwicklungen und Vorbereitungen auf dem EG-Binnenmarkt*. In: Bruns, G. & Häuser, K. (ed.) (1990). *Europa 1992 und der Kapitalmarkt*. Frankfurt: Fritz Knapp Verlag.
194. Stewart, G.B. (1999). *The Quest for Value*. New York, NY: HarperCollins Publishers.
195. Stiglitz, J.E. (1993). *Economics*. New York, NY: W.W. Norton & Company.
196. Strauss, A. & Corbin, J. (1990). *Basics of qualitative research: Grounded theory procedures and techniques*. London: Sage Publications.
197. Strauss, A. & Corbin, J. (1994). *Grounded Theory methodology: An overview*. In: Denzin, N.K. & Lincoln, Y.S. (eds.) (1994). *Handbook of Qualitative Research*. London: Sage Publications.
198. Strauss, A. (1987). *Qualitative Analysis for Social Scientists*. Cambridge: Cambridge University Press.
199. Stucken, R. (1957). *Geld und Kredit*. Tübingen: Mohr.
200. Süchting, J. (1992). *Bankmanagement*. Stuttgart: Schäffer-Poeschel Verlag.
201. Sun Tzu (1963). *The Art of War*. Translated and with an introduction by Samuel B. Griffith. Foreword by B.H. Liddell Hart. Oxford: Oxford University Press.
202. Swann, D. (ed.) (1992). *The single European market and beyond: A study of the wider implications of the Single European Act*. London: Routledge.
203. Swann, D. (ed.) (1995). *The Economics of the Common Market - Integration in the European Union*. London: Penguin.
204. Swary, I. and Topf, B. (1992). *Global Financial Regulation*. Cambridge: Blackwell.
205. Taylor, P. (1983). *The Limits of European Integration*. London: Croom Helm.

206. Taylor, R. (1993). *Going for Broke: How Banking Mismanagement in the Eighties Lost Billions*. New York, NY: Simon & Schuster.
207. Tinbergen, J. (1954). *International Economic Integration*. Amsterdam: Elsevier.
208. Vander Weyer, M. (2000). *Falling Eagle: The Decline of Barclays Bank*. London: Orion Books.
209. Varian, H.R. (1990). *Intermediate Microeconomics*. New York, NY: W.W. Norton & Company.
210. Viner, J. (1950). *The Customs Union Issue*. New York, NY: Carnegie Endowment for International Peace.
211. Wee, C.-H. & Lee Sun K.-S. (1996). *Sun Tzu War & Management*. Reading, MA: Addison Wesley Longman.
212. Weick, K.E. (1969). *The Social Psychology of Organizing*. Reading, MA: Addison Wesley.
213. Whittington, R. (1993). *What is Strategy - and does it really matter?* London: Routledge.
214. Winton, J.R. (1982). *Lloyds Bank, 1918-1969*. Oxford: Oxford University Press.
215. Yin, R.K. (1994). *Case study research*. Thousand Oaks: Sage Publications.

B) Journals and periodicals

216. Ackoff, R.L. (1983). Beyond Prediction and Preparation. *Journal of Management Studies*, Vol. 10, No. 1, pp. 59-69.
217. Adamides, E.D. et al. (2003). Economic integration and strategic change the role of managers' mental models. *Strategic Change*, March-April 2003, Vol. 12, pp. 69-82.
218. Allen, F. (1990). The Market for Information and the Origin of Financial Intermediation. *Journal of Financial Intermediation* Vol. 1, No. 1, pp. 3-30.
219. Allen, F. & Gale, D. (2000). Financial Contagion. *The Journal of Political Economy*, Vol. 108, No. 1, pp. 1-33.
220. Altunbas, Y. Goddard, J & Molyneux, P. (1999). Technical change in banking. *Economics Letters*, Vol. 64, pp. 215-221.
221. Anderson, P. (1999). Complexity Theory and Organization Science. *Organization Science*, Vol. 10, No. 3, May-June 1999, pp. 216-232.
222. Anderson, P. et al. (1999). Applications of Complexity Theory to Organization Science. *Organization Science*, Vol. 10, No. 3, pp. 233-236.
223. Argyris, C. (1977). Double loop learning in organizations. Cambridge, MA: Harvard Business Review, September-October 1977, pp. 115-125.
224. Astley, W.G. & Fombrun, C. (1983). Strategies of Collection Action: The Case of the Financial Services Industry. In Lamb, R. (ed.) (1983). *Advances in Strategic Management*, Vol. 2. Greenwich, CT: JAI Press.
225. Bain, J.S. (1951). Relation of profit rate to industry concentration: American manufacturing, 1936-1940. *Quarterly Journal of Economics*, Vol. 65, pp. 293-324.
226. Bartlett, C.A. & Ghoshal, S. (1987). Managing across Borders: New Strategic Requirements. *Sloan Management Review*, Summer 1987, pp. 7-17.
227. Bátiz-Lazo, B. & Wood, D. (2000). Effects of regulatory change on European banks: a case study on the strategy and stock market performance of Lloyds Bank 1980-1993. *Journal of European Financial Services*, Vol. 4, No. 1, pp. 31-63.
228. Beck, T., Levine, R. & Loayza, N. (2000a). Financial Intermediation and Growth: Causality and Causes. *Journal of Monetary Economics* Vol. 46, pp. 31-47.
229. Beck, T., Levine, R. & Loayza, N. (2000b). Finance and the Sources of Growth. *Journal of Financial Economics* Vol. 58, October/November, 261-300.
230. Benston, G.J., Hanweck, G.A. & Humphrey, D.B. (1982). Scale economies in banking: A restructure and reassessment. *Journal of Money, Credit and Banking*, Vol. 14, pp. 435-456.

231. Berger, A.N. & Humphrey, D.B. (1992). Megamergers in Banking and the Use of Cost Efficiency as an Antitrust Defense. *Antitrust Bulletin*, Vol. 37, pp. 541-600.
232. Berger, A.N. & Humphrey, D.B. (1997). Efficiency of financial institutions: International survey and directions for future research. *European Journal of Operational Research*, Vol. 98, pp. 175-212.
233. Berger, A.N., Demsetz, R.S. & Strahan, P.E. (1999). The consolidation of the financial services industry: Causes, consequences, and implication for the future. *Journal of Banking and Finance*, Vol. 23, No. 2, pp. 135-194.
234. Bhattacharya, S. et al., (1998). The Economics of Bank Regulation. *Journal of Money, Credit and Banking*, Vol. 30, No. 4, pp. 745-770.
235. Bikker, J.A., & Groeneveld J.M. (2000). Competition and Concentration in the EU Banking Industry. *Kredit und Kapital*, Vol. 33, No. 1, pp. 62-98.
236. Boeker, W. & Hayward, M.L.A. (1998). Power and conflicts of interest in professional firms: Evidence from investment banking. *Administrative Science Quarterly*, March 1998, Vol. 43, No. 1.
237. Boot, A.W.A. (2000). Relationship Banking: What do we know? *Journal of Financial Intermediation*, Vol. 9, pp. 7-25.
238. Bose, P. & Morgan, A. (1998). Banking on shareholder value. London: *McKinsey Quarterly*, Issue 2, pp. 96.
239. Boyd, J. & Prescott, E.C. (1986). Financial Intermediary Coalitions. *Journal of Economic Theory* Vol. 38, pp. 211-232.
240. Brandenburger, A.M. & Nalebuff, B.J. (1995). *The Right Game: Use Game Theory to Shape Strategy*. Cambridge, MA: Harvard Business Review, August 1995, No. 57.
241. Brothman, B. (1991). Orders of Value: Probing the Theoretical Terms of Archival Practice. *Archivaria* Vol. 32, Summer 1991, pp. 78-100.
242. Bryan, L.L. (1993). The forces reshaping global banking technology and demography are changing the deep foundations on which traditional financial services rest. New York, NY: *The McKinsey Quarterly*, 1993 No. 2, pp. 59-72.
243. Butt Philip, A. (1978). The Integration of Financial Markets in Western Europe. *Journal of Common Market Studies*, Vol. 16, No 4, pp.302-322.
244. Butt Philip, A. (1982). Pressure Groups and Policy Formation in the European Communities. *Policy and Politics*, Vol. 10, No 4, pp. 459-475.
245. Camerer, C. & Weigelt, K. (1988). Reputation and Corporate Strategy: A Review of Recent Theory and Applications. *Strategic Management Journal*, No. 9, pp. 443-454.
246. Campbell, A. & Yeung, S. (1991). *Creating a Sense of Mission*. Long Range Planning, Vol. 24, No. 4, pp. 10-20. Oxford: Elsevier Science.

247. Canals, J. (1999). Scale Versus Specialization: Banking Strategies After the Euro. *European Management Journal* Vol. 17, No. 6, pp. 567-575.
248. Canals, J. (2001). How to Think about Corporate Growth? *European Management Journal* Vol. 19, No. 6, pp. 587-598.
249. Cecchetti, S.G. (1999). Legal Structure, Financial Structure, and the Monetary Policy Transmission Mechanism. Federal Reserve Bank of New York, *Economic Policy Review*, Vol. 5, No. 2, pp. 9-28.
250. Chan, R.Y. & Wong Y. H. (1999). Bank generic strategies: does Porter's theory apply in an international banking center. *International Business Review*, Vol. 8, No. 5-6, October 1999, pp. 561-590.
251. Chelley-Steeley, P.L. & Steeley, J.M. (1999). Changes in the Co-movement of European Equity Markets. *Economic Inquiry* Vol. 37, No. 3, pp. 473-488.
252. Clarotti, P. (1984). Progress and Future Development of Establishment and Services in the EC in Relation to Banking. *Journal of Common Market Studies*, Vol. 22, No. 3.
253. Cohen, M.D., March, J.G., Olsen, J.P. (1972). A garbage can model of organizational choice. *Administrative Science Quarterly*, Vol. 17, pp. 1-25.
254. Cook, T. (2001). Archival Science and Postmodernism: New Formulations for Old Concepts. *Archival Science* Vol. 1, No. 1.
255. Crane, D.B. & Bodie, Z. (1996). Form Follows Function: The Transformation of Banking. Cambridge, MA: Harvard Business Review Vol. 74, No. 2, March-April 1996, pp. 109-117.
256. Dawar, N. & Frost, T. (1999). Competing with Giants - Survival Strategies for Local Companies in Emerging Markets. Cambridge, MA: Harvard Business Review, March-April 1999.
257. Degryse, H. & Ongena, S. (2005). Distance, Lending Relationships, and Competition. *The Journal of Finance*, Vol. LX, No. 1, February 2005.
258. Dermine, J. (1996). European banking integration, ten years after. *European Financial Management*, Vol. 2, No. 3, pp.331-353.
259. Dewald, W.G., Thursby, J.G., & Anderson, R.G. (1986). Replication in empirical economics: The Journal of Money, Credit and Banking Project. *American Economic Review* Vol. 76. pp. 587-603.
260. Diamond, D.W. & Dybvig, P.H. (1983). Bank Runs, Deposit Insurance, and Liquidity. *The Journal of Political Economy*, Vol. 91, No. 3, pp. 401-419.
261. Diamond, D.W. (1984). Financial Intermediation and Delegated Monitoring. *Review of Economic Studies*, Vol. 51, pp. 393-414.
262. Diamond, D.W. (1996). Financial Intermediation as Delegated Monitoring, a Simple Example. *Economic Quarterly of the Federal Reserve Bank of Richmond*. Vol. Summer 1996. pp. 51-66.

263. Dornbusch, R., Favero, C. & Giavazzi, F. (1998). Immediate Challenges for the European Central Bank, *Economic Policy*, No. 26, April, pp. 15-64 (including discussion).
264. Duranti, L. (1994). The records: where archival universality resides. *Archival Issues*, Vol. 19, pp. 83-94.
265. Dyer, J.H.; Kale, P. & Singh, H. (2004). When to Ally & When to Acquire. Cambridge, MA: Harvard Business Review, July-August 2004, Vol. 82, No. 7/8, pp. 108-115.
266. Eisenhardt, K.M. (1989). Building Theories from Case Study Research. *Academy of Management Review*, Vol. 14, No. 4, pp. 532-550.
267. Evered, R. (1983). So what is strategy? *Long Range Planning*, Vol. 16, No. 3, pp. 57-72.
268. Focarelli, D., Panetta, F. & Salleo, C. (2002). Why do banks merge? *Journal of Money, Credit & Banking*, Vol. 34, Issue 4.
269. Franzetti, C. (2002). Insurance-based Investment Banking - Szenario von Konkurrenz und Kooperation. *Die Bank*, Vol. 12, pp. 632-638.
270. Ghemawat, P. (2005). Regional Strategies for Global Leadership. Cambridge, MA: Harvard Business Review, December 2005.
271. Ghoshal, S. & Kim, S.K. (1986). Building Effective Intelligence Systems for Competitive Advantage. *Sloan Management Review*, Fall 1986, pp. 49-58.
272. Ghoshal, S. & Nohria, N. (1993). Horses for Courses: Organizational Forms for Multinational Corporations. *Sloan Management Review*, Winter 1993, pp. 23-35.
273. Gilligan, T., Smirlock, M. & Marshall, W. (1984). Scale and Scope Economies in the Multi-Product Banking Firm. *Journal of Monetary Economics*, Vol. 13, pp. 393-405.
274. Ginsberg, A. & Venkatraman, N. (1985). Contingency Perspectives of Organizational Strategy. *Academy of Management Review* No. 10, pp. 421-434.
275. Goodhart, C. (1987). Why do banks need a central bank? *Oxford Economic Papers* No. 39. pp. 75-89.
276. Granovetter, M. (1985). Economic Action and Social Structure: The Problem of Embeddedness. In: *American Journal of Sociology*, Vol. 91. pp. 481-510.
277. Grant, R.M. (1991). The resource-based theory of competitive advantage: implications for strategy formulation. *California Management Review*, Spring, pp. 114-35.
278. Greenwald, B. & Kahn, J. (2005). All Strategy is Local. Cambridge, MA: Harvard Business Review, September 2005.
279. Hackethal, A. & Schmidt, R.H. (2000). Finanzsystem und Komplementarität. in: *Beihefte zu Kredit und Kapital*, No. 15:

Finanzmärkte im Umbruch, pp. 53-102.

280. Hamel, G. & Prahalad, C.K. (1989). Strategic intent. Cambridge, MA: Harvard Business Review, May-June 1989, pp. 63-76.
281. Hamel, G. & Prahalad, C.K. (1990). The core competence of the corporation. Cambridge, MA: Harvard Business Review, May-June 1990, pp.71-91.
282. Hamel, G. & Prahalad, C.K. (1993). Strategy as Stretch and Leverage. Cambridge, MA: Harvard Business Review, March-April 1993, pp. 75-84.
283. Hamel, G. (1991). Competition for competence and interpartner learning within international strategic alliances. Strategic Management Journal, No. 12, Summer Special Issue, pp. 83-103.
284. Hannan, M.T. & Freeman, J. (1977). The Population Ecology of Organizations. American Journal of Sociology. Vol. 82, No. 5, pp. 929-964.
285. Hannan, M.T. & Freeman, J. (1984). Structural Inertia and Organizational Change. American Sociological Review. Vol. 49, No. April, pp. 149-164.
286. Heil, O. & Robertson, T.S. (1991). Toward a Theory of Competitive Market Signaling: A Research Agenda. Strategic Management Journal, No. 12, pp. 403-418.
287. Henderson, B.D. (1989). The origin of strategy. Cambridge, MA: Harvard Business Review, November December 1989, pp. 139-143.
288. Hoffmann, S. (1966). Obstinate or Obsolete: the Fate of the Nation State and the Case of Western Europe. Daedalus, Vol. 95, No. 2, pp. 862-915.
289. Hofstede, G. (1993). Cultural constraints in management theories. Academy of Management Executive, Vol. 7, No. 1, pp. 81-94.
290. Hout, T.M., Porter, M.E. & Rudden, E. (1982). How Global Companies Win Out. Cambridge, MA: Harvard Business Review, September-October 1982.
291. Jayaratne, J. & Strahan, P.E. (1996). The Finance-Growth Nexus: Evidence from Bank Branch Deregulation. Quarterly Journal of Economics Vol. 111, pp. 639-670.
292. Jimerson, R.C. (2003). Archives and Manuscripts - Archives and Memory. OCLC Systems & Services, Vol. 19, No. 3, pp. 89-95.
293. Johnson, R.T. (2000). In search of E.I. DuPont de Nemours & Company: the perils of archival research. Accounting, Business & Financial History, Vol. 10, No. 2, pp. 129-168.
294. Kaplan, E. (2000). We are what we collect, we collect what we are: archives and the construction of identity. American Archivist, Vol. 63, pp. 126-51.

295. Kim, E., Nam, D. & Stimpert, J.L. (2004). The Applicability of Porter's Generic Strategies in the Digital Age: Assumptions, Conjectures, and Suggestions. *Journal of Management*, Vol. 30, No. 5, pp. 569-589.
296. King, R.G. & Levine, R. (1993a). Finance and Growth: Schumpeter may be right. *Quarterly Journal of Economics*, Vol. 108, pp. 713-737.
297. King, R.G. & Levine, R. (1993b). Finance, Entrepreneurship and Growth. *Journal of Monetary Economics*, Vol. 32, pp. 513-542.
298. Klemperer, P. (1987). Markets with consumer switching costs. *Quarterly Journal of Economics*, Vol. 102, pp. 375-394.
299. La Porta, R., Lopez-de-Silanes, F., Shleifer, A. & Vishny, R. (1997). Legal Determinants of External Finance. *Journal of Finance*, Vol. 52, pp. 1131-1150.
300. La Porta, R., Lopez-de-Silanes, F., Shleifer, A. & Vishny, R. (1998). Law and Finance. *Journal of Political Economy*, Vol. 106, pp. 1113-1156.
301. Lamberti, H.J. (2004). *Industrialisierung des Bankgeschäfts*. Berlin: Die Bank, Issue 6-7/2004.
302. Leland, H. & Pyle, D. (1977). Informational Asymmetries, Financial Structure, and Financial Intermediation. *Journal of Finance* Vol. 32, pp. 371-387.
303. Levitt, T. (1983). The Globalization of Markets. *Cambridge, MA: Harvard Business Review*, May-June 1983, pp. 92-102.
304. Lindblom, C.E. (1959). The Science of 'Muddling Through'. *Public Administration Review*, Vol. 19, Spring 1959, pp. 79-88.
305. Lindblom, C.E. (1979). Still Muddling, Not Yet Through. *Public Administration Review*, Vol. 39.
306. Lipsey, R. (1957). The Theory of Customs Unions: Trade Diversion and Welfare. *Economica*, Vol. 24, pp. 40-6.
307. Lipsey, R. (1960). The Theory of Customs Unions: A General Survey. *Economic Journal*, Vol. 70, pp. 496-513.
308. Majone, G. & Wildavsky, A. (1978). Implementation as Evolution. *Policy Studies Review Annual*, No. 2, pp. 103-117.
309. Mann, M.H. (1966). Seller Concentration, Entry Barriers, and Rates of Return in Thirty Industries. *Review of Economics and Statistics*, Vol. 48, pp. 296-307.
310. Mason, E.S. (1939). Price and production policies of large scale enterprise. *American Economic Review*, Vol. 29, pp. 61-74.
311. Mason, E.S. (1949). The current state of the monopoly problem in the United States. *Harvard Law Review*, Vol. 62, pp. 1265-1285.
312. Mathur S.S. (1984). Competitive industrial marketing strategies. *Long Range Planning*, Vol. 17, Issue 4 August 1984, pp. 102-109.

313. McCutcheon, D. & Meredith, J. (1993). Conducting case study research in operations management. *Journal of Operations Management*, Vol. 11 No. 3, pp. 239-56.
314. McGahan, A. M. & Porter, M.E. (1997). How Much Does Industry Matter, Really? Special Issue. *Strategic Management Journal*, Vol. 18, summer 1997, pp. 15-30.
315. Merton, R. (1987). A simple model of capital market equilibrium with incomplete information. *Journal of Finance*, Vol. 42, pp. 483-510.
316. Mintzberg, H. & Waters, J.A. (1985). Of strategies, deliberate and emergent. *Strategic Management Journal*, Vol. 6, pp. 257-272.
317. Mintzberg, H. (1978). Patterns in Strategy Formation. *Management Science*, Vol. 24, No. 9, pp. 934-948.
318. Mintzberg, H. (1987a). Crafting strategy. Cambridge, MA: Harvard Business Review, July-August 1987, pp. 65-75.
319. Mintzberg, H. (1987b). The Strategy Concept I: Five Ps for Strategy. *California Management Review*; Fall 1987, Vol. 30, Issue 1, pp. 11-24.
320. Molyneux, P., Lloyd-Williams, D.M. & Thornton, J. (1994). Competitive Conditions in European Banking. *Journal of Banking and Finance*, Vol. 18, No. 3, pp. 445-459.
321. Nesmith, T. (1999). Still Fuzzy, But More Accurate: Some Thoughts on the 'Ghosts' of Archival Theory. *Archivaria*, Vol. 47, Spring 1999, pp. 136-150.
322. Pagano, M. (1993). Financial Markets and Growth: An Overview. *European Economic Review*, No. 37, pp. 613-622.
323. Peters, T.J. (1984). Strategy follows structure: developing distinctive skills. *California Management Review*, Vol. 16, No. 3, pp. 111-125.
324. Pettigrew, A.M. & Webb, D. (1999). The temporal development of strategy: patterns in the UK insurance industry. *Organization Science*, Vol. 10, No. 5, Sept-Oct. 1999, pp. 601-621.
325. Pettigrew, A.M. (1977). Strategy Formulation as a Political Process. *International Studies of Management and Organization*. Summer, pp. 78-87.
326. Pettigrew, A.M. (1990). Longitudinal field research on change: theory and practice. *Organization Science*, Vol. 1, No. 3, pp. 267-292.
327. Phillips, A. (1976). A critique of empirical studies of relations between market structure and profitability. *Journal of Industrial Economics*, Vol. 24, pp. 241-249.
328. Pitman, B. (2000). Objectives for Lloyds TSB. *Management Today*, 23 June 2000.
329. Pitman, B. (2003). Leading for value. Cambridge, MA: Harvard Business Review, April 2003, pp. 41-46.

- 330. Porter, M.E. (1979). *How Competitive Forces Shape Strategy*. Cambridge, MA: Harvard Business Review, Vol. 57, No. 2, March-April 1979, pp. 137-145.
- 331. Porter, M.E. (1996). *What Is Strategy?* Cambridge, MA: Harvard Business Review No. 61.
- 332. Quinn, J.B. (1978). *Strategic Change: Logical Incrementalism*. Sloan Management Review. Fall 1978, pp. 7-21.
- 333. Quinn, J.B. (1980b). *Managing Strategic Change*. Sloan Management Review. Summer 1980, pp. 3-20.
- 334. Quinn, J.B. (1989). *Strategic Change: Logical Incrementalism - SMR Classic Reprint*. Sloan Management Review. Fall 1989, pp. 45-60.
- 335. Rajan, R.G. & Zingales, L. (1998). *Financial Dependence and Growth*. American Economic Review, Vol. 88, pp. 559-587.
- 336. Ramakrishnan, R. & Thakor, A. (1984). *Information Reliability and a Theory of Financial Intermediation*. Review of Economic Studies, Vol. 51, pp. 415-432.
- 337. Rhoades, S.A. (1998). *The efficiency effects of bank mergers: an overview of case studies of nine mergers*. Journal of Banking and Finance, Vol. 22, pp. 273-291.
- 338. Royal, C. (2003). *Snakes and career ladders in the investment banking industry: the making of Barclays De Zoete Wedd (BZW) - an international perspective, 1982-96*. Accounting, Business & Financial History, Vol. 13, No. 2, July 2003, pp. 233-262.
- 339. Rumelt, R.P. (1991). *How much does industry matter?* Strategic Management Journal. Vol. 12 No. 3, pp. 167-185.
- 340. Rybczynski, T.M. (1984). *Industrial Financial Systems in Europe, US and Japan*. in: Journal of Economic Behaviour and Organization, Vol. 5, pp. 275-286.
- 341. Rybczynski, T.M. (1988). *Financial systems and industrial restructuring*. National Westminster Bank Quarterly Review, November, pp. 3-13.
- 342. Schmalensee, R. (1985). *Do markets differ much?* American Economic Review, Vol. 75, No. 3, pp. 341-351.
- 343. Schmidt, R.H. & Tyrell, M. (1997). *Financial Systems, Corporate Finance and Corporate Governance*. European Financial Management, Vol. 3, pp.159-187.
- 344. Schmidt, R.H. (2001). *The Future of Banking in Europe*. In: Financial Markets and Portfolio Management, Vol. 15, No. 4, pp. 429-449.
- 345. Sealey, C.W. & Lindley, J.T. (1977). *Inputs, Outputs, and a Theory of Production and Cost at Depository Financial Institutions*. Journal of Finance, Vol. 32, pp. 1251-1266.
- 346. Senge, P.M. (1990). *The Leader's new work: building learning organizations*. Sloan Management Review, Vol. 32, No.1, pp.7-23.

- 347. Tinbergen, J. (1957). Customs unions: influence of their size on their effect. *Zeitschrift der gesamten Staatswissenschaften*, No. 113, pp. 404-414.
- 348. Tripoli, A.M. (1998). Planning and Allocating: Strategies for Managing Priorities in Complex Jobs. *European Journal of Work and Organizational Psychology*, Vol. 7, No. 4, pp. 455-476.
- 349. Vander Vennet, R. (1996). The Effects of Mergers and Acquisitions on the Efficiency and Profitability of EC Credit Institutions. *Journal of Banking and Finance*, Vol. 20, No. 9, pp. 1531-1558.
- 350. Vander Vennet, R. (2002). Cost and Profit Efficiency of Financial Conglomerates and Universal Banks in Europe. *Journal of Money, Credit, and Banking*, Vol. 34, pp. 254-282.
- 351. Vives, X. (1991). Regulatory reform in European banking. *European Economic Review*, Vol. 35, pp. 505-515.
- 352. Voss, C., Tsiriktsis, N. & Frohlich, M. (2002). Case research in operations management. *International Journal of Operations & Production Management*, Vol. 22, No. 2, pp. 195-219.
- 353. Wheelock, D.C. & Wilson, P.W. (2000). Why Do Banks Disappear? The Determinants of U.S. Bank Failures and Acquisitions. *Review of Economics and Statistics*, Vol. 82, pp. 127-138.
- 354. Wrapp, H.E. (1967). Good managers don't make policy decisions. Cambridge, MA: *Harvard Business Review*, September-October 1967, pp. 91-99.
- 355. Yip, G.S. (1982). *Gateways to Entry*. Cambridge, MA: *Harvard Business Review*, No. 60, September-October 1982, pp. 85-93.

C) Publications by research institutes, universities and think tanks

356. Beckmann, R., Eppendorfer, C. & Neimke, M (2002a). Deepening European Financial Integration: Theoretical Considerations and Empirical Evaluation of Growth and Employment Benefits. Bochum: Ruhr-University of Bochum.
357. Beckmann, R., Eppendorfer, C. & Neimke, M (2002b). Market Access Strategies in the EU Banking Sector Obstacles and Benefits towards an integrated European Retail Market. Bochum: Ruhr-University of Bochum.
358. Belaisch, A. et al. (2001). Euro-Area Banking at the Crossroads. IMF Working Paper 01/28. Washington DC: IMF.
359. Berger, A.N. & Humphrey, D.B. (1992). Measurement and efficiency issues in commercial banking. In Griliches, Z. (ed.) (1992). Output Measurement in the Service Sectors. National Bureau of Economic Research Studies in Income and Wealth, Vol. 56, Chicago, IL: University of Chicago Press.
360. Berger, A.N. & Udell, G.F. (2003). The institutional memory hypothesis and the procyclicality of bank lending behaviour. BIS Working Papers No 125. Basel: Bank for International Settlements.
361. Berger, A.N. (2000). The Integration of the Financial Services Industry: Where are the Efficiencies? Board of Governors of the Federal Reserve System, Working Paper.
362. Berger, A.N., De Young, R. & Udell, G. (2000). Efficiency Barriers to the Consolidation of the European Financial Services Industry. Board of Governors of the Federal Reserve System, Working Paper.
363. Berger, A.N., Demsetz, R.S. & Strahan, P.E. (1998). The Consolidation of the Financial Services Industry: Causes, Consequences, and Implications for the Future. New York: Federal Reserve Bank of New York.
364. Berger, A.N., DeYoung, R., Genay, H. & Udell, G. (2000). Globalization of Financial Institutions: Evidence from Cross-Border Banking Performance. Brookings-Wharton Papers on Financial Services 3, pp. 23-158.
365. Brookes, M. (1999). The impact of EMU on portfolio management. EIB Papers, Vol. 4, No. 1. Luxembourg: European Investment Bank.
366. Buch, C.M. & DeLong, G.L. (2001). Cross-Border Bank Mergers: What Lures the Rare Animal? Kiel Working Paper No. 1070. Kiel: Kiel Institute of World Economics.
367. Buch, C.M. & Heinrich, R.P. (2002). Financial Integration in Europe and Banking Sector Performance. Kiel. Kiel Institute of World Economics.
368. Buch, C.M. (2000). Information or Regulation: What is Driving the International Activities of Commercial Banks? Kiel Working Paper No. 1011. Kiel: Kiel Institute of World Economics.

- 369. Buch, C.M. (2001a). Financial Market Integration in a Monetary Union. Kiel Working Paper No. 1062. Kiel: Kiel Institute of World Economics.
- 370. Buch, C.M. (2001b). Cross-Border Banking and Transmission Mechanisms: The Case of Europe. Kiel Working Paper No. 1063. Kiel: Kiel Institute of World Economics.
- 371. Cabral, I., Dierick, F. & Vesala, J. (2002). Banking Integration in the Euro Area. ECB Occasional Paper No. 6. March. Frankfurt: European Central Bank.
- 372. Canals, J. (1996). Financial intermediaries and capital markets: an international perspective. Research Paper No. 320, July 1996, IESE, University of Navarra.
- 373. Canals, J. (1996). Universal banks: the need for corporate renewal. Research Paper No. 321, July 1996, IESE, University of Navarra.
- 374. Canals, J. (1998). Banks as shareholders: Do they matter? Research Paper No. 354, January 1998, IESE, University of Navarra.
- 375. Carletti, E. & Hartmann, P. (2002). Competition and Stability: What's special about banking? ECB Working Paper No. 146. Frankfurt: European Central Bank.
- 376. Cetorelli, N. (1999). Competitive analysis in banking: Appraisal of the methodologies. Economic Perspectives. Chicago, IL: Federal Reserve Bank of Chicago.
- 377. Ciampolini, M. & Rhode, B. (2000). Money Market Integration: A Market Perspective. Ref. paper presented at the European Central Bank Conference "The Operational Framework of the Eurosystem and Financial Markets", Frankfurt, 5-6 May 2000.
- 378. Danthine, J.-P., Giavazzi, F. & Thadden, E.-L. von (2000). European financial markets after EMU: a first assessment. Centre for Economic Policy Research (CEPR). Discussion paper 2413. London: CEPR.
- 379. Davis, E.P. (1997). Pension Reforms and European Financial Markets. Special Paper No. 107, Financial Markets Group, London School of Economics.
- 380. De Ryck, K. (1997). EMU and pension funds. Brussels: European Federation for Retirement Provision.
- 381. Dermine, J. (1999). The case for a European-wide strategy. EIB Papers, Vol. 4, No. 1. Luxembourg: European Investment Bank.
- 382. Deutsche Bank Research (2002). EU on the bumpy road to a single market in financial services. Frankfurt Voice - EU Financial Market Special. Frankfurt: Deutsche Bank.
- 383. Deutsche Bank Research (2003). Towards a Single Euro Payments Area. Frankfurt Voice - EU Financial Market Special. Frankfurt: Deutsche Bank.
- 384. Deutsche Bank Research (2004). Bank performance in Europe: great progress through consolidation - except in Germany. EU Monitor – EU

- Financial Market Special. Frankfurt: Deutsche Bank.
385. Economists Advisory Group Ltd. (1981). The British and German banking system: a comparative study. London: Anglo-German Foundation.
386. Eugen-Gutmann-Gesellschaft (2006). Research Project "Dresdner Bank in the Third Reich" [online]. Frankfurt: Eugen-Gutmann-Gesellschaft / Dresdner Bank. Available from: <http://www.eugen-gutmann-gesellschaft.de/> [Accessed 5 December 2006].
387. Fitch Ratings (2004). Dresdner Bank AG. Frankfurt: Fitch Ratings, 25 October 2004.
388. Fitch Ratings (2005). The Royal Bank of Scotland Group plc. London: Fitch Ratings, 23 August 2005.
389. Flemings Research. (2000). Banks: It's a rich man's world - Wealth management in Europe. London: Robert Fleming & Co Limited.
390. Frankfurter Institut (2001). Privatisierung von Landesbanken und Sparkassen. Schriftenreihe. Band 38. Bad Homburg: Frankfurter Institut - Stiftung Marktwirtschaft und Politik.
391. Fratzscher, M. (2001). Financial Market Integration in Europe: On the Effects of EMU on Stock Markets. European Central Bank. Working Paper No. 48. March. Frankfurt: European Central Bank.
392. Giannetti, M. et al. (2002). Financial Market Integration, Corporate Financing and Economic Growth. Economic Papers No. 179. Brussels: European Commission.
393. Goldman Sachs (1998a). Sector Versus Country - When is an Asset Class an Asset Class? London: Goldman Sachs Portfolio Strategy.
394. Goldman Sachs (1998b). The Goldman Sachs / Watson Wyatt EMU Survey - Summary of Results. London: Goldman Sachs Equity Derivatives Research.
395. Grote, M.H. & Umber, M.P. (2006). Home biased? A spatial analysis of the domestic merging behaviour of US firms. Working Paper Series: Finance & Accounting, No. 161. Frankfurt: University of Frankfurt, Department of Finance.
396. Gual, J. & Neven, D. (1993). Deregulation of the European Banking Industry, in: European Economy/Social Europe, No. 3, pp. 151-183.
397. Gual, J. (1999). Deregulation, Integration and Market Structure in European Banking, University of Navarra, Working Paper.
398. Hackethal, A. & Schmidt, R.H. (2005). Structural change in the German Banking system? Working Paper Series: Finance & Accounting No. 147. Frankfurt: Johann Wolfgang Goethe-University.
399. Hackethal, A. & Tyrell, M. (1999). Complementarity and Financial Systems. Working Paper Series: Finance & Accounting No. 10. Frankfurt: Johann Wolfgang Goethe-University.

400. Hackethal, A. (2001). Strategic Groups in European Commercial Banking. Discussion Paper No. 01-19. Vallendar: German Economic Association for Business Administration.
401. Hawawini, G., Subramanian, V. & Verdin, P. (2000). When does industry matter? An empirical study using EVA and MVA. Discussion Paper, Catholic University of Leuven.
402. Historische Gesellschaft der Deutschen Bank (undated). Themen [online]. Frankfurt: Historische Gesellschaft der Deutschen Bank. Available from: http://www.bankgeschichte.de/index_04.html [Accessed 17 January 2007].
403. Holzmann, R. (1999). The World Bank Approach to Pension Reform. Washington, DC: The World Bank.
404. Hoover's Company Records (2007). Commerzbank. Austin: Hoover's.
405. Hoymann, G. (2000). Sector Insight Banks: Dresdner Bank - Hold. Frankfurt: Metzler Equity Research, 22 May 2000.
406. Hoymann, G. (2000). Sector Insight Banks: Commerzbank - Sell. Frankfurt: Metzler Equity Research, 4 September 2000.
407. Hoymann, G. (2000). Sector Insight Banks: Hypovereinsbank - Buy. Frankfurt: Metzler Equity Research, 16 October 2000.
408. Hoymann, G. (2003). Sector Insight Banks: Commerzbank - Sell. Frankfurt: Metzler Equity Research, 6 February 2003.
409. Hurst, C., Perée, E. & Fischbach, M. (1999). On the road to wonderland? Bank restructuring after EMU. EIB Papers, Vol. 4, No. 1, pp. 83-103. Luxembourg: European Investment Bank.
410. Janssen, S. (2003). Sector Insight Insurance: Allianz - Buy. Frankfurt: Metzler Equity Research, 21 March 2003.
411. Janssen, S. (2003). Germany: Key obstacles confound bank restructuring. Oxford Analytica Daily Brief, 3 December 2003. Oxford: Oxford Analytica.
412. Janssen, S. (2003a). Company Report: ING, Fortis and Allianz. Frankfurt: Metzler Equity Research, 3 February 2003.
413. Janssen, S. (2003b). Company Report: Deutsche Börse - Buy. Frankfurt: Metzler Equity Research, 24 June 2003.
414. Janssen, S. (2004). Company Report: Allianz - Buy. Frankfurt: Metzler Equity Research, 5 March 2004.
415. Klatzky, R.L. (1997). Allocentric and Egocentric Spatial Representations: Definitions, Distinctions, and Interconnections. Department of Psychology, Carnegie Mellon University, Pittsburgh: Carnegie Mellon University.
416. Kleimeier, S. & Sander, H. (2002). Consumer Credit Rates in the Eurozone. Brussels: ECRI Research Report.

417. Lefort F. & Walker, E. (2002). Pension Reform and Capital Markets: Are There Any (Hard) Links? Washington, DC: The World Bank.
418. Liberti, J. & Mian, A. (2006). Estimating the effect of hierarchies on information use. London: London Business School & University of Chicago.
419. Llewellyn, D.T. (2005). Competition and Profitability in European Banking: Why Are British Banks So Profitable? Siena: Economic Notes by Banca Monte dei Paschi di Siena SpA, Vol. 34, No. 3.
420. London Economics, PricewaterhouseCoopers & Oxford Economic Forecasting (2002). Quantification of the Macro-Economic Impact of Integration of EU Financial Markets. Final Report to the European Commission - Directorate-General for the Internal Market. London: London Economics.
421. Mantel, J. (1999). European Pension Reforms. London: Merrill Lynch.
422. Marquez, R. & Hauswald, R. (2004). Competition and Strategic Information Acquisition in Credit Markets. American University Washington & University of Maryland.
423. Mishkin, F.S. & Strahan, P.E. (1999). What Will Technology Do to Financial Structure? Washington/Philadelphia: Brookings-Wharton Papers on Financial Services, pp. 249-287.
424. Munn, C.W. (undated). Scottish Banking History [online]. Edinburgh: The Committee of Scottish Clearing Bankers. Available from: <http://www.scotbanks.org.uk/history.htm> [Accessed 25 May 2006].
425. Narayanan, V.K. (undated). Environmental Analysis for Strategy Formulation. Original paper from Professor V.K. Narayanan, Stubbs Professor of Strategy & Entrepreneurship, Drexel University, Philadelphia.
426. Peristiani, S. (1993). The Effects of Mergers on Bank Performance. Federal Reserve Bank of New York, Studies on Excess Capacity in the Financial Sector.
427. Reich, N. & van Aken, J.C. (1994). The Evolution of Community Law on Financial Services. ZERP-Diskussionspapier 1/94. Zentrum für Europäische Rechtspolitik. Universität Bremen.
428. Schmidt, R.H. & Grote, M.H. (2005). Was ist und was braucht ein bedeutender Finanzplatz? Working Paper Series: Finance & Accounting No. 150. Frankfurt: Johann Wolfgang Goethe-University.
429. Schmidt, R.H. (1999). Differences between Financial Systems in European Countries: Consequences for EMU. Working Paper Series: Finance & Accounting No. 35. Frankfurt: Johann Wolfgang Goethe-University.
430. Schmidt, R.H., Hackethal, A. & Tyrell M. (1998). Disintermediation and the Role of banks in Europe: An International Comparison. Working Paper Series: Finance & Accounting No. 10. Frankfurt: Johann Wolfgang Goethe-University.

- 431. Sen, M. (1998). Sector Insight German Banks. Frankfurt: Metzler Equity Research, 24 July 1998.
- 432. Sen, M. (1998). Sector Insight German Banks. Frankfurt: Metzler Equity Research, 3 November 1998.
- 433. Sen, M. (1998). Sector Insight German Banks: Commerzbank - Sell. Frankfurt: Metzler Equity Research, 10 November 1998.
- 434. Sen, M. (1999). Company Study: Dresdner Bank - Buy. Frankfurt: Metzler Equity Research, 19 January 1999.
- 435. Sen, M. (1999). Sector Insight German Banks: Commerzbank - Sell. Frankfurt: Metzler Equity Research, 29 March 1999.
- 436. Sheridan, J. & Napier, J. (2005). Lloyds TSB - Turning the tanker. London: Deutsche Bank AG.
- 437. Stirboeck, C. & F. Heinemann, (1999). Capital Mobility within EMU. ZEW, Zentrum fuer Europaeische Wirtschaftsforschung GmbH. Discussion paper, pp. 99-19, Mannheim.
- 438. The Boston Consulting Group (2000). Vom Risk Taker zum Risk Manager - Zehn Thesen für ein umfassendes Risikomanagement in Banken. Ergebnisse einer weltweiten BCG-Studie.
- 439. Vander Vennet, R. (1998). Causes and consequences of EU bank takeovers. In Eijffinger, S. et al. (eds.) (1998). The Changing European Landscape. Brussels: Centre for Economic Policy Research.
- 440. Vander Vennet, R. (1998). Cost and Profit Dynamics in Financial Conglomerates and Universal Banks in Europe. Paper presented for the SUERF/CFS Colloquium, Frankfurt, 15-17 October 1998.
- 441. Wagenvoort, R & Schure, P. (1999). Who are Europe's efficient bankers? EIB Papers, Vol. 4, No. 1, pp. 105-126. Luxembourg: European Investment Bank.
- 442. Walter, I. (1999). Financial services strategies in the euro-zone. EIB Papers, Vol. 4, No. 1. Luxembourg: European Investment Bank.
- 443. Walter, I. (2002). Financial integration across borders and across sectors: implications for regulatory structures. Unpublished paper. Available from Ingo Walter's homepage: <http://pages.stern.nyu.edu/~iwalter/> [Accessed 2 June 2005].
- 444. White, W.R. (1998). The coming Transformation of Continental European Banking? Basle: BIS Working Papers No. 54.
- 445. Whitehouse, E. (1998). Pension Reform in Britain. Washington, DC: The World Bank.
- 446. Ziegler, D. (2003). Eugen Gutmann: Unternehmer und Grossbuerger. Frankfurt: Eugen-Gutmann-Gesellschaft e.V.

D) Articles from newspapers, magazines and news agencies

- 447. AFX (1997). Vereinsbank's Schmidt says new bank aims for 15 pct return on equity. Munich: AFX, 21 July 1997.
- 448. AFX (2003). HVB plans to cut costs by 15 pct in many areas this yr. Frankfurt: AFX, 18 February 2003.
- 449. AFX News (1992). HSBC Holdings names John Bond Group CEO. London: AFX News, 2 November 1992.
- 450. AFX News (1999). RBoS to sell RBS Trust Bank to Bank of New York. London: AFX News, 23 March 1999.
- 451. Andrews, E.L. (1998). Bank giant: the overview; Deutsche gets Bankers Trust for \$ 10 billion. New York, NY: The New York Times, 1 December 1998.
- 452. Associated Press (1988). Citizens' shareholders ok acquisition by Scotland Bank. New York, NY: Associated Press, 21 September 1988.
- 453. Associated Press (1997). Vereinsbank und Bayern Hypo werden neuer Bankenriese. Washington, DC: Associated Press, 21 July 1997.
- 454. Associated Press (2001). Mehr HypoVereinsbank-Filialen Vereins- und Westbank und Norisbank wechseln Schilder; Bis zu 90 Geschaeftsstellen schliessen. Washington, DC: Associated Press, 12 June 2001.
- 455. Atkins, R. (1996). Companies and Finance - Lloyds TSB ends uncertainty over Hill Samuel. London: Financial Times, 1 June 1996.
- 456. Bank Marketing International (2003). Telephone banking pioneer First Direct embraces the Internet. London: Lafferty Ltd, 28 August 2003.
- 457. Barber, L. (1999). HypoVereinsbank provisions on eastern property were correct. London: Financial Times, 25 October 1999.
- 458. Barber, T. (1998). Alliance banks on speedy integration: Deutsche and Bankers Trust aim for a rapid convergence of cultures. London: Financial Times, 1 December 1998.
- 459. Barber, T. (1998). Dresdner Bank eyes buys and mergers. London: Financial Times, 24 November 1998.
- 460. Barber, T. (1998). HypoVereinsbank provisions up DM 3.5bn. London: Financial Times, 29 October 1998.
- 461. Barber, T., Lewis, W. & Major, T (2000). Deutsche/Dresdner - The merger that never was. London: Financial Times, 12 April 2000.
- 462. Barchard, D. (1992). Lloyds plans to shut down merchant banking division. London: Financial Times, 20 October 1992.
- 463. Barker, T. (1999). Barclays aims to save GBP 300 million in banking review. London: Financial Times, 1 February 1999.
- 464. BBC online (2002). Pensions scandal costs £11.8bn. London: BBC, 27

June 2002. Available from:
<http://news.bbc.co.uk/2/hi/business/2070271.stm> [Accessed 16 July 2005].

465. Bender, Y. (2004). Big player with a European focus: Commerzbank's Paul Burik explains to Yuri Bender the thinking behind its asset management group's curtailed ambitions. London: Financial Times, 11 October 2004.
466. Bennett, N. (1992). Lloyds closes merchant bank division. London: The Times, 20 October 1992.
467. Benoit, B. (1999). Clouds still hang over Dresdner Bank. London: Financial Times, 29 November 1999.
468. Blanden, M. (1993). Merchant Banks: Now you see them, now you don't - Once you could spot a merchant bank. Now you'd be hard pushed - they've all gone their different ways. London: The Banker, 1 March 1993.
469. Böhringer, S. (1999). Tochter der HypoVereinsbank will schneller sein als der Markt. Munich: Süddeutsche Zeitung, 3 November 1999.
470. Böhringer, S. (2002). Dieter Rampl führt die HypoVereinsbank. Munich: Süddeutsche Zeitung, 24 October 2002.
471. Bolger, A. (2001). Barclays and L&G unveil alliance. London: Financial Times, 17 January 2001.
472. Bolger, A. (2005). Widows pays its dues and looks ahead. London: Financial Times, 18 April 2005.
473. Börse Online (2001). Wir fühlen uns stark genug. Börse Online: Munich, 1 March 2001.
474. Börsen-Zeitung (1993). Bayerische Vereinsbank opens new regional branch in central Berlin. Frankfurt: Börsen-Zeitung, 9 June 1993.
475. Börsen-Zeitung (1995). Aufstiegskandidat BZW. Frankfurt: Börsen-Zeitung, 20 September 1995.
476. Börsen-Zeitung (1995). Dresdner Bank-Ergebnis noch unter Vorjahr; Sarrazin: Grünes Licht für Kooperation mit BNP - Antrag auf Einzelentlastungen gestellt. Frankfurt: Börsen-Zeitung, 20 May 1995.
477. Börsen-Zeitung (1995). Dresdner Bank bietet 1 Milliarde Pfund; Kleinwort ein strategischer Partner. Frankfurt: Börsen-Zeitung, 27 June 1995.
478. Börsen-Zeitung (1995). Merck, Finck: 5 Jahre überdecken Erfolgsstory; Privatbank in den neunziger Jahren grundlegend geändert. Frankfurt: Börsen-Zeitung, 4 July 1995.
479. Börsen-Zeitung (1995). Hypo-Bank gründet Schweizer Tochter; Konzentration auf institutionelles Investmentgeschäft - Rolle als "Nischen-Player". Frankfurt: Börsen-Zeitung, 20 July 1995.
480. Börsen-Zeitung (1995). Vereinsbank zieht Treasury aus Frankfurt ab;

- Konzentration auf München und London - Nächster Schritt nach New York? Frankfurt: Börsen-Zeitung, 10 August 1995.
481. Börsen-Zeitung (1995). Singapur als Sprungbrett für die Vereinsbank. Frankfurt: Börsen-Zeitung, 1 December 1995.
482. Börsen-Zeitung (1996). Barclays hat zuviel Kapital angesammelt; Aktienrückkauf fuer gut 300 Mill. Pfund - Ertrag vor Risikovorsorge sinkt um 5 Prozent. Frankfurt: Börsen-Zeitung, 28 February 1996.
483. Börsen-Zeitung (1996). BV startet mit Advance Bank "neue Direktbank-Generation". Frankfurt: Börsen-Zeitung, 23 March 1996.
484. Börsen-Zeitung (1996). Barclays kauft wieder eigene Aktien zurück; 470 Mill. Pfund für 3,5 Prozent des Kapitals - Grosse Produktivitätsfortschritte. Frankfurt: Börsen-Zeitung, 7 August 1996.
485. Börsen-Zeitung (1997). Gespräche über neue Adig-Eigentümerstruktur; BV signalisiert Interesse an Übernahme von Commerzbank-Anteil - Realteilung als Alternative. Frankfurt: Börsen-Zeitung, 17 June 1997.
486. Börsen-Zeitung (1997). Bayerische Bankenhochzeit mit "cleverer" Tauschaktion; BV will zunächst Beteiligung von bis zu 45 Prozent an Hypo-Bank - Ziel von 15 Prozent Nettoeigenkapitalrendite. Frankfurt: Börsen-Zeitung, 22 July 1997.
487. Börsen-Zeitung (1997). Dresdner Bank erhöht Kapital 20:1; Kooperation mit Allianz wird ausgebaut. Frankfurt: Börsen-Zeitung, 30 July 1997.
488. Börsen-Zeitung (1997). Bank Boston kauft Deutsche Bank Argentina. Frankfurt: Börsen-Zeitung, 30 September 1997.
489. Börsen-Zeitung (1997). Dresdner erwirbt Advance Bank; Mit Direktbank-Plänen am Ziel. Frankfurt: Börsen-Zeitung, 22 October 1997.
490. Börsen-Zeitung (1997). Barclays sucht neuen Weg im Investmentbanking; Marktauftritt als integrierter Fremdkapitalspezialist - Der Euro soll neue Türen öffnen. Frankfurt: Börsen-Zeitung, 14 November 1997.
491. Börsen-Zeitung (1997). S&P stuft Dresdner Bank zurück; Mässige Kapitalisierung - Ausblick von negativ auf stabil. Frankfurt: Börsen-Zeitung, 14 November 1997.
492. Börsen-Zeitung (1998). Keine weitere Verflechtung geplant;"Grosser Strick" mit Generali geknüpft - Vor Adig-Entscheidung. Frankfurt: Börsen-Zeitung, 12 November 1998.
493. Börsen-Zeitung (1998). Leonberger zur Württembergischen; Commerzbank verkauft Anteil und konzentriert sich auf Badenia. Frankfurt: Börsen-Zeitung, 10 December 1998.
494. Börsen-Zeitung (1999). Adig an Commerzbank verkauft; HypoVereinsbank übernimmt 11 Mrd. DM aus den Fonds. Frankfurt: Börsen-Zeitung, 2 February 1999.
495. Börsen-Zeitung (1999). Adig an Commerzbank verkauft;

- HypoVereinsbank übernimmt 11 Mrd. DM aus den Fonds. Frankfurt: Börsen-Zeitung, 23 February 1999.
496. Börsen-Zeitung (1999). Merck Finck bekommt neuen Eigentümer; Barclays verkauft Münchner Privatbank für 500 Mill. DM an Kredietbank S.A. Luxembourgeoise. Frankfurt: Börsen-Zeitung, 26 March 1999.
497. Börsen-Zeitung (1999). Adig Investment feilt an neuem Konzept; Bis Jahresende Klarheit - Commerzbank verhandelt mit "Restgesellschaften" über deren Ausstieg. Frankfurt: Börsen-Zeitung, 29 July 1999.
498. Börsen-Zeitung (1999). Commerzbank: Wahlverwandtschaften stärken; Europäische Partner zurückhaltend - Fokussierung auf klar verhandelbare geschäftliche Ziele. Frankfurt: Börsen-Zeitung, 4 September 1999.
499. Börsen-Zeitung (1999). Direkt Anlage Bank kommt zu 12,50 Euro. Frankfurt: Börsen-Zeitung, 13 November 1999.
500. Börsen-Zeitung (2000). Bilanzpressekonferenz der Deutschen Bank. Frankfurt: Börsen-Zeitung, 7 April 2000.
501. Börsen-Zeitung (2000). Barclays macht deutlich Boden gut; Halbjahresgewinn fast verdoppelt - Internet-Banking forciert. Frankfurt: Börsen-Zeitung, 4 August 2000.
502. Börsen-Zeitung (2000). Deutsche Bank erhält Zuschlag für National Discount Brokers. Frankfurt: Börsen-Zeitung, 13 October 2000.
503. Börsen-Zeitung (2001). Barclays schließt zur Konkurrenz auf; Florierendes Retail-Banking-Geschäft - Woolwich setzt positive Akzente - Paneuropäische Ambitionen. Frankfurt: Börsen-Zeitung, 9 February 2001.
504. Börsen-Zeitung (2001). Deutsche Bank erhält grünes Licht. Frankfurt: Börsen-Zeitung, 20 March 2001.
505. Börsen-Zeitung (2001). Die Aktionäre der HVB-Tochter sind zufrieden; DAB-Vorstand stellt für 2003 Konzerngewinn in Aussicht - Absage an Reintegration in die HypoVereinsbank. Frankfurt: Börsen-Zeitung, 18 May 2001.
506. Börsen-Zeitung (2001). DAB beim Stellenabbau in der Zielgeraden; Personalkosten sollen um bis zu 20 Prozent sinken. Frankfurt: Börsen-Zeitung, 20 September 2001.
507. Börsen-Zeitung (2002). Wir müssen die Nummer eins werden. Frankfurt: Börsen-Zeitung, 6 April 2002.
508. Börsen-Zeitung (2002). DAB Bank will Selftrade ganz. Frankfurt: Börsen-Zeitung, 18 July 2002.
509. Börsen-Zeitung (2003). DAB Bank verkauft Schweizer Tochter an Sarasin; Online-Broker im Ausland noch in Österreich aktiv. Frankfurt: Börsen-Zeitung, 24 January 2003.
510. Börsen-Zeitung (2003). Deutsche Bank kassiert Milliarden-Tranche.

Frankfurt: Börsen-Zeitung, 4 February 2003.

511. Börsen-Zeitung (2003). Dresdner Bank nimmt sich länger Zeit für strikteren Sparkurs; Streichungen im Back-office - Karenzzeit für das Investment Banking. Frankfurt: Börsen-Zeitung, 15 August 2003.
512. Börsen-Zeitung (2003). Royal Bank of Scotland setzt auf deutschen Markt. Frankfurt: Börsen-Zeitung, 1 October 2003.
513. Börsen-Zeitung (2004). Weitere Einsparungen sind nach Jahr mit Rekordverlust kein Thema mehr; Commerzbank erreicht Kostenziel ein Jahr früher als geplant - Erträge sinken um rund 5 Prozent - Bei Milliardenabschreibung "für Mut belohnt" - Dividende entfällt. Frankfurt: Börsen-Zeitung, 19 February 2004.
514. Börsen-Zeitung (2004). HVB rührt die Werbetrommel vor der Kapitalerhöhung. Frankfurt: Börsen-Zeitung, 12 March 2004.
515. Börsen-Zeitung (2004). Interview mit Kurt F. Viermetz. Frankfurt: Börsen-Zeitung, 23 April 2004.
516. Börsen-Zeitung (2004). Private Equity und USA belasten Deutsche Bank. Frankfurt: Börsen-Zeitung, 4 June 2004.
517. Börsen-Zeitung (2004). Die letzte operative Einheit findet eine neue Heimat. Frankfurt: Börsen-Zeitung, 30 September 2004.
518. Börsen-Zeitung (2006). Lone Star gerät in Südkorea wegen KEB unter Beschuss; Staatsanwaltschaft wirft illegale Praktiken vor. Frankfurt: Börsen-Zeitung, 8 December 2006.
519. Bowe, C. (2000). Survey - Global custody. London: Financial Times, 14 July 2000.
520. Bowley, G. (1998). Deutsche Bank in talks on Japan venture. London: Financial Times, 28 July 1998.
521. Brenner, B. (1993). WPZ-Gruppe übernimmt Berner Bank von Ernst. Zurich: Neue Zürcher Zeitung, 22 January 1993.
522. Brown-Humes, C. (1997). Lloyds leaves private function. London: Financial Times, 27 August 1997.
523. Buchholz, A. (1999). Schmidt kündigt harte Kurskorrektur an. Munich: Süddeutsche Zeitung, 26 March 1999.
524. Buchholz, A. (2001). HVB legt Filialen der Töchter zusammen. Munich: Süddeutsche Zeitung, 13 June 2001.
525. Buchholz, A. (2002). HypoVereinsbank erstmals mit Verlust. Munich: Süddeutsche Zeitung, 26 July 2002.
526. Burgess, K. & Croft, J. (2003). Lloyds TSB fined Pounds 1.9m by FSA for mis-selling: The bank has agreed to pay Pounds 98m in compensation, London: Financial Times, 26 September 2003.
527. Business Week Online (2003). AIG's Asian Connection. New York: Business Week Online, 15 September 2003.

528. Business Week Online (2006). HSBC's Lessons in Outsourcing. New York: Business Week 27 January 2006.
529. Business Week (2002). Peter Drucker's Search for Community. New York: Business Week, 24 December 2002.
530. Cameron, D., Croft, J. & Hegmann, G. (2002). HVB raises its bad debt forecasts by 20 per cent. London: Financial Times, 26 July 2002.
531. Capell, K. (2005). A whiz and a whirlwind. Business Week International Editions, 30 May 2005.
532. Capital (1999). Der harte Regent. Hamburg: Capital, 1 February 1999.
533. Capon, A. & Marshall, J. (1998). HSBC weighs its asset management options. London: Euromoney, June 1998.
534. Clow, R. & Wine, E. (2001). Market cheers Deutsche purchase of Scudder. London: Financial Times, 26 September 2001.
535. Cohen, N. & Gapper, J. (1993). Barclays appoints banking outsider as chief executive. London: Financial Times, 20 August 1993.
536. Cohen, N. (1995). Kleinwort Benson chief to depart. London: Financial Times, 14 June 1995.
537. Corrigan, T. & Lewis, W (1997). Barclays plan for new momentum after BZW sale. London: Financial Times, 23 October 1997.
538. Corrigan, T. & Lewis, W. (1997). Barclays to break up BZW - British bank plans to sell key parts of investment arm in big restructuring. London: Financial Times, 3 October 1997.
539. Cox, R. & Smith, A. (1998). A banker in the spotlight; How will Josef Ackermann fare in leading Deutsche Bank's takeover of Bankers Trust? London: The Independent, 6 December 1998.
540. Croft, J. & Cameron, D. (2000). Lloyds TSB drops launch of Evolvebank. London: Financial Times, 14 December 2000.
541. Croft, J. & Levitt, J. (2003). Royal Bank of Scotland expands credit card business with Santander Central deal. London: Financial Times, 15 May 2003.
542. Croft, J. & Pretzlick, C. (2003). 'Quiet American' ready with charm offensive. London: Financial Times, 16 April 2003.
543. Croft, J. (2000). Evolvebank puts back launch date. London: Financial Times, 29 November 2000.
544. Croft, J. (2003). Relishing the spoils of victory: RBS has reaped huge benefits from its successful integration of NatWest. London: Financial Times, 4 January 2003.
545. Croft, J. (2004). Making a rod for its own back? Case study Royal Bank of Scotland. London: Financial Times, 8 October 2004.
546. Croft, J., Orr, R. & Nichol, M. (2003). Lloyds TSB grappling with the problem of weakened Black Widow. London: Financial Times, 27

September 2003.

547. Davies, S. (1998). Barclays' infant off to a good start. London: Financial Times, 14 April 1998.
548. Denton, N. & Harverson, P. (1995). Merger poses threat to Hill Samuel's future. London: Financial Times, 10 October 1995.
549. Denton, N. & Smith, A. (1995). Lloyds and TSB poised for merger - GBP 15 billion deal would create third largest retail bank. London: Financial Times, 10 October 1995.
550. Denton, N. (1996). ING attacks German rival over staff poaching. London: Financial Times, 6 June 1996.
551. Denton, N. (1996). Irresistible pull of the poachers: The large pay packages to persuade investment bankers to switch employers are causing concern in the industry. London: Financial Times, 8 June 1996.
552. Denton, N. (1996). Royal Bank of Scotland buys Warburg's share custody unit. Financial Times, London: 2 August 1996.
553. Denton, N., Cohen, N. & Parkes, C. (1994). Deutsche Bank mulls UK move. London: Financial Times, 26 September 1994.
554. Die Welt (1999). Direkt Anlage Bank plant vorsichtige Auslandsexpansion. Berlin: Die Welt, 16. November 1999.
555. Dixon, H. (1998). How Barclays' chief came to grief - Four key events and four knights. London: Financial Times, 30 November 1998.
556. dpa-AFX (2004). "WiWo": Deutsche Bank an Lloyds TSB interessiert - Bank: erwägen keine Fusion. Frankfurt: dpa-AFX, 22 September 2004.
557. Dries, F. (1995). Vereinsbank will Investmentbanking stärken; Schmidt: "Wir gehen sehr wählerisch vor" - Kapitalerhöhung verschafft notwendiges Pulver. Frankfurt: Börsen-Zeitung, 3 May 1995.
558. Dries, F. (1998). Das Ticket nach Amerika. Frankfurt: Börsen-Zeitung, 24 November 1998.
559. Dwyer, P. & Holland, K. (1993). At Barclays, a stiff upper lip no longer suffices. New York: Business Week, 12 April 1993.
560. Dwyer, P. (1995). Can Barclays really make more money by lending less? New York: Business Week, 10 April 1995.
561. Ewing, J. et al. (1999). Fixing Deutsche Bank. New York: Business Week, 19 July 1999.
562. Fairlamb, D. & Reed, S. (2001). Why Lloyds can't stop hunting - Even it gets Abbey, it needs a European deal to keep growing. New York: Business Week, 5 March 2001.
563. Felsted, A. & Major, T. (2000). HVB plans sale of F&C stake. London: Financial Times, 5 September 2000.
564. Financial Times (1982). Groups overtaken by international banking. London: Financial Times, 10 May 1982.

- 565. Financial Times (1984). Commerzbank to buy rest of Europartners. London: Financial Times, 24 November 1984.
- 566. Financial Times (1990). Bayerische Vereinsbank announces Spanish cooperation agreement. London: Financial Times, 10 September 1990.
- 567. Financial Times (1990). Bayerische Vereinsbank to start East German operations on July 1. London: Financial Times, 29 June 1990.
- 568. Financial Times (1990). Buoyant Dresdner Bank plans East German growth. London: Financial Times, 11 April 1990.
- 569. Financial Times (1990). Dresdner Bank reports results for first ten months 1990. London: Financial Times, 30 November 1990.
- 570. Financial Times (1990). Lloyds Bank suffers record annual GBP 715m losses. London: Financial Times, 24 February 1990.
- 571. Financial Times (1990). Lloyds to sell its operations in Portugal. London: Financial Times, 19 June 1990.
- 572. Financial Times (1991). Allianz boosts holding in Dresdner Bank to 23 per cent. London: Financial Times, 30 July 1991.
- 573. Financial Times (1991). Joint venture between Banque Nationale De Paris, Dresdner Bank and OKHB faces EC Inquiry. London: Financial Times, 11 January 1991.
- 574. Financial Times (1993). Editorial Comment - Learning from Barclays. London: Financial Times, 5 March 1993.
- 575. Financial Times (1993). People - Barclays beefs up bancassurance. London: Financial Times, 23 June 1993.
- 576. Financial Times (1994). Observer - Midland shanghaied. London: Financial Times, 6 April 1994.
- 577. Financial Times (1995). The Lex column - Barclays. London: Financial Times, 22 June 1995.
- 578. Financial Times (1998). PEOPLE - Teeuw to head Barclays division in Europe. London: Financial Times, 8 December 1998.
- 579. Financial Times (1999). Lex Column - Dresdner Bank. London: Financial Times, 22 September 1999.
- 580. Financial Times (1999). Lex Column - Dresdner Bank. London: Financial Times, 1 October 1999.
- 581. Financial Times (2000). Lex Column - Dresdner Bank. London: Financial Times, 20 May 2000.
- 582. Financial Times (2003). Lex Column - Lloyds TSB. London: Financial Times, 25 October 2003.
- 583. Financial Times (2004). Radical surgery saved Merrill. London: Financial Times, 2 July 2004.
- 584. Financial Times Deutschland (2000). Lichter aus im Powerhouse.

Hamburg: Financial Times Deutschland, 6 April 2000.

585. Fisher, A. & Denton, N. (1996). Deutsche Bank expands to take on US rivals. London: Financial Times, 29 March 1996.
586. Fisher, A. & Harris, C. (1998). Bank in need of tune-up: Andrew Fisher and Clay Harris speak to the head of Deutsche Bank about his restructuring plans. London: Financial Times, 11 February 1998.
587. Fisher, A. & Harris, C. (1998). Deutsche doubtful on French expansion. London: Financial Times, 9 February 1998.
588. Fisher, A. & Urry, M. (1995). Vereinsbank abandons attempt to buy Oppenheimer. London: Financial Times, 15 December 1995.
589. Fisher, A. (1995). Dresdner Bank confident despite fall in first half. London: Financial Times, 10 August 1995.
590. Fisher, A. (1995). Dresdner Bank expands in US. London: Financial Times, 30 November 1995.
591. Fisher, A. (1995). International Company News - Bayerische Vereinsbank to raise DM 1bn. London: Financial Times, 3 April 1995.
592. Fisher, A. (1995). US buy raises Dresdner Bank's profile. London: Financial Times, 18 December 1995.
593. Fisher, A. (1996). Vereinsbank forms direct banking unit. London: Financial Times, 25 March 1996.
594. Fisher, A. (1997). A reluctant departure: With so many changes still to come, the chairman of Deutsche Bank regrets that it is time to step down. London: Financial Times, 13 May 1997.
595. Fisher, A. (1997). Dresdner Bank to raise DM 1.8bn 'war chest'. London: Financial Times, 30 July 1997.
596. Fisher, A. (1997). MGAM may cost Deutsche £ 450m. London: Financial Times, 27 March 1997.
597. Fisher, A. (1997). UBS pays Lloyds USD 190 million for SMH. London: Financial Times, 27 August 1997.
598. Fisher, A. (1998). Deutsche Bank aims to double profit by 2001. London: Financial Times, 3 April 1998.
599. Fisher, A. (1998). Dresdner Bank ahead. London: Financial Times, 23 February 1998.
600. Fisher, A. (1998). Out of the ivory tower - The Monday Profile - Bernhard Walter, Dresdner Bank. London: Financial Times, 2 February 1998.
601. Focus Magazin (1997). Kraftprobe auf bayerisch. Munich: Focus Magazin, 28 July 1997.
602. Frankfurter Allgemeine Zeitung (1993). Commerzbank erhöht Gewinn durch den Eigenhandel. Frankfurt: Frankfurter Allgemeine Zeitung, 8 May 1993.

603. Frankfurter Allgemeine Zeitung (1993). Deutsche Bank stärkt Präsenz in Norditalien. Frankfurt: Frankfurter Allgemeine Zeitung, 25 November 1993.
604. Frankfurter Allgemeine Zeitung (1993). Vereins- und Westbank expandiert im Osten. Frankfurt: Frankfurter Allgemeine Zeitung, 18 June 1993.
605. Frankfurter Allgemeine Zeitung (1994). Das Krisenjahr der Metallgesellschaft. Frankfurt: Frankfurter Allgemeine Zeitung, 5 December 1994.
606. Frankfurter Allgemeine Zeitung (1994). Die Commerzbank ist mit dem Jahresauftakt 1994 zufrieden. Frankfurt: Frankfurter Allgemeine Zeitung, 16 April 1994.
607. Frankfurter Allgemeine Zeitung (1994). Höheres Betriebsergebnis bei der Dresdner Bank. Frankfurt: Frankfurter Allgemeine Zeitung, 21 May 1994.
608. Frankfurter Allgemeine Zeitung (1996). Das Unternehmergespräch. Frankfurt: Frankfurter Allgemeine Zeitung, 28 October 1996.
609. Frankfurter Allgemeine Zeitung (1997). Bankenfusion weckt keinen Handlungsbedarf bei der Deutschen Bank. Frankfurt: Frankfurter Allgemeine Zeitung, 24 July 1997.
610. Frankfurter Allgemeine Zeitung (1997). Commerzbank stellt sich auf die Seite Thyssens. Frankfurt: Frankfurter Allgemeine Zeitung, 20 March 1997.
611. Frankfurter Allgemeine Zeitung (1997). Die Commerzbank rechnet mit einem ausgesprochen guten Jahr. Frankfurt: Frankfurter Allgemeine Zeitung, 7 November 1997.
612. Frankfurter Allgemeine Zeitung (1997). Rheinmetall steigt bei Kolbenschmidt ein. Frankfurt: Frankfurter Allgemeine Zeitung, 6 March 1997.
613. Frankfurter Allgemeine Zeitung (1998). Die Commerzbank baut ihr Geschäft in London aus. Frankfurt: Frankfurter Allgemeine Zeitung, 6 May 1998.
614. Frankfurter Allgemeine Zeitung (1998). Dresdner Bank zieht einen Schlusstrich unter das harte Jahr 1997. Frankfurt: Frankfurter Allgemeine Zeitung, 27 March 1998.
615. Frankfurter Allgemeine Zeitung (1999). Holzmann-Gläubiger finden keine Einigung. Frankfurt: Frankfurter Allgemeine Zeitung, 19 November 1999.
616. Frankfurter Allgemeine Zeitung (2000). Die Commerzbank muss die Strategie ueberdenken. Frankfurt: Frankfurter Allgemeine Zeitung, 13. March 2000.
617. Frankfurter Allgemeine Zeitung (2000). Dresdner und Commerzbank nahezu einig. Frankfurt: Frankfurter Allgemeine Zeitung, 14 July 2000.

618. Frankfurter Allgemeine Zeitung (2000). Cobra heizt Spekulationen um die Commerzbank weiter an. Frankfurt: Frankfurter Allgemeine Zeitung, 18. Mai 2000.
619. Frankfurter Allgemeine Zeitung (2000). Die Deutsche Bank plant eine Europa-Bank. Frankfurt: Frankfurter Allgemeine Zeitung, 2 August 2000.
620. Frankfurter Allgemeine Zeitung (2000). Dresdner Bank und Commerzbank gehen weiter getrennte Wege. Frankfurt: Frankfurter Allgemeine Zeitung, 27 July 2000.
621. Frankfurter Allgemeine Zeitung (2000). Wie sich Dresdner Bank und Commerzbank für die Aktionäre schön rechnen. Frankfurt: Frankfurter Allgemeine Zeitung, 19 July 2000.
622. Frankfurter Allgemeine Zeitung (2001). Zur Zeit hat die Commerzbank keine Fusionspläne. Frankfurt: Frankfurter Allgemeine Zeitung, 13 June 2001.
623. Frankfurter Allgemeine Zeitung (2001). Alle Bankfilialen unter HVB-Logo. Frankfurt: Frankfurter Allgemeine Zeitung, 13 June 2001.
624. Frankfurter Allgemeine Zeitung (2001). Holzmann darf Bundeshilfen erhalten. Frankfurt: Frankfurter Allgemeine Zeitung, 9 May 2001.
625. Frankfurter Allgemeine Zeitung (2002). Commerzbank erwartet im ersten Quartal wieder einen Gewinn. Frankfurt: Frankfurter Allgemeine Zeitung, 10 April 2002.
626. Frankfurter Allgemeine Zeitung (2002). Commerzbank öffnet Fondsvertrieb. Frankfurt: Frankfurter Allgemeine Zeitung, 14 March 2002.
627. Frankfurter Allgemeine Zeitung (2002). Commerzbank stellt den Fondsmanager Jupiter zum Verkauf. Frankfurt: Frankfurter Allgemeine Zeitung, 28 February 2002.
628. Frankfurter Allgemeine Zeitung (2002). Deutsche Bank beschleunigt den Verkauf von Beteiligungen. Frankfurt: Frankfurter Allgemeine Zeitung, 6 November 2002.
629. Frankfurter Allgemeine Zeitung (2002). Vereins- und Westbank in Tallinn. Frankfurt: Frankfurter Allgemeine Zeitung, 2 April 2002.
630. Frankfurter Allgemeine Zeitung (2003). Commerzbank will mehr Kredit geben; Scharfe Kritik auf der Hauptversammlung / Müller legt Bezüge offen. Frankfurt: Frankfurter Allgemeine Zeitung, 31 May 2003.
631. Frankfurter Allgemeine Zeitung (2004). Ein polnisches Schmuckstück soll die Commerzbank verschönern; Kreditinstitut baut strategische Position im Osten Europas aus / BRE-Bank in Warschau macht nach zwei Verlustjahren wieder Gewinn. Frankfurt: Frankfurter Allgemeine Zeitung, 4 September 2004.
632. Frey, E. & Major, T. (2000). HVB to take over Bank Austria. London: Financial Times, 24 July 2000.

- 633. Frey, E. & Major, T. (2000). HypoVereinsbank strengthens its strategy. London: Financial Times, 24 July 2000.
- 634. Fromme, H. & Jenkins, P. (2003). Gerling gets injection of Euros 180m fresh funds. London: Financial Times, 30 April 2003.
- 635. Fromme, H. (2002). Deutsche Bank puts pressure on Gerling to opt for sale. London: Financial Times, 15 March 2002.
- 636. Funds International (1995). Vereinsbank fails to bag Oppenheimer. London: Funds International / Lafferty, December 1995.
- 637. Gapper, J. & Mason, J. (1994). Lloyds bid for C and G halted by High Court ruling. London: Financial Times, 9 June 1994.
- 638. Gapper, J. & Sharpe, A. (1994). UK company news - Lloyds rises 29% to GBP 1.03 billion. London: Financial Times, 12 February 1994.
- 639. Gapper, J. & Smith, A. (1994). Men in the News: Duo hits the high notes - Andrew Longhurst and Brian Pitman. London: Financial Times, 23 April 1994.
- 640. Gapper, J. (1992). Project Columbus sets about trimming the crew. London: Financial Times, 20 November 1992.
- 641. Gapper, J. (1993). Barclays making heavy charges for US assets. London: Financial Times, 6 August 1993.
- 642. Gapper, J. (1994). Can HSBC Holdings persuade doubters in the City that global commercial banking makes sense? London: Financial Times, 1 March 1994.
- 643. Gapper, J. (1994). Taylor takes Barclays into the reform club. London: Financial Times, 21 April 1994.
- 644. Gapper, J. (1995). Lloyds and TSB shares rise as city backs merger plan. London: Financial Times, 12 October 1995.
- 645. Gapper, J. (1995). Lloyds in moves to reduce capital. London: Financial Times, 7 August 1995.
- 646. Gapper, J. (1996). Asset management merger at Barclays. London: Financial Times, 16 October 1996.
- 647. Gapper, J. (1996). Barclays arm acts as private exchange. London: Financial Times, 24 January 1996.
- 648. Garfield, A. (2000). NatWest pension fund may yield pounds 2 bn surplus for the Royal Bank. London: The Independent, 22 May 2000.
- 649. Gemperle, R. (2000). HypoVereinsbank übernimmt Bank Austria. Zurich: Neue Zürcher Zeitung, 24 July 2000.
- 650. Graham, G. & Martinson, J. (1997). Sale of BZW equities unit hits Barclays' global aims. London: Financial Times, 4 October 1997.
- 651. Graham, G. & Targett, S. (2000). Barclays achieves reversal of fortunes. London: Financial Times, 16 February 2000.

- 652. Graham, G. (1996). Lloyds reaffirms insurance ambitions. London: Financial Times, 24 September 1996.
- 653. Graham, G. (1997). Midland surge boosts HSBC. London: Financial Times, 4 March 1997.
- 654. Graham, G. (1997). UK not ready for EMU, says Barclays chief. London: Financial Times, 26 March 1997.
- 655. Graham, G. (1997). Peter Wood to leave as head of Direct Line. London: Financial Times, 26 June 1997.
- 656. Graham, G. (1997). Lloyds TSB in brand link-up. London: Financial Times, 2 August 1997.
- 657. Graham, G. (1997). Lloyds TSB to look at overseas acquisitions - Surplus cash could fund change of strategy. London: Financial Times, 2 August 1997.
- 658. Graham, G. (1998). Lloyds TSB gives first hint of buy-back. London: Financial Times, 14 February 1998.
- 659. Graham, G. (1998). Barclays call centre to create 2,000 jobs. London: Financial Times, 27 February 1998.
- 660. Graham, G. (1999). Consumer lending growth spurs Barclay. London: Financial Times, 17 June 1999.
- 661. Graham, G. (1998). Barclays prepares for economic downturn. London: Financial Times, 7 August 1998.
- 662. Graham, G. (1999). Widows a good catch for Lloyds. London: Financial Times, 23 June 1999.
- 663. Graham, G. (1999). Barclays sends corporate staff out on the road. London: Financial Times, 22 September 1999.
- 664. Graham, G. (1999). Lloyds TSB sets out internet stall. London: Financial Times, 22 October 1999.
- 665. Graham, G. (1999). A key leader in financial services - Lloyds TSB. London: Financial Times, 7 December 1999.
- 666. Graham, G. (2000). HSBC to plug Wall Street gap via US link-up. London: Financial Times, 5 January 2000.
- 667. Grant, J. (1999). No merger for Deutsche Bank. London: Financial Times, 1 September 1999.
- 668. Gries, L. (2002). Dresdner Bank tritt erneut auf die Kostenbremse. Munich: Süddeutsche Zeitung, 27 September 2002.
- 669. Gries, L. (2002). Gemischte Gefühle - Wie sich Allianz und Dresdner Bank ein Jahr nach Bekanntgabe der Fusion. Munich: Süddeutsche Zeitung, 28 March 2002.
- 670. Gries, L. (2002). Stimmung in der Dresdner Bank auf dem Nullpunkt. Munich: Süddeutsche Zeitung, 2 March 2002.

- 671. Griffiths, K. (2001). Merger speculation increases as Lloyds TSB admits Deutsche talks. London: The Independent, 26 November 2001.
- 672. Griffiths, K. (2004). HSBC outsourcing claims infuriate unions. London: The Independent, 2 July 2004.
- 673. Hall, W. & Reed, J. (2000). Austria set to act as gateway to east for HypoVereinsbank. London: Financial Times, 8 August 2000.
- 674. Hall, W. (1996). Creditanstalt's sorry saga: The privatisation of Austria's leading bank has been stalled by politics. London: Financial Times, 16 September 1996.
- 675. Hamel, G. (1997). Killer strategies that make shareholders rich. Fortune, 23 June 1997, pp. 70-86.
- 676. Hargreaves, D. (2001). Brussels helps out Holzmann. London: Financial Times, 9 May 2001.
- 677. Harris, C. & Martinson, J. (1997). BZW to be sold off in parts - Barclays fails to find one buyer for arm. London: Financial Times, 5 November 1997.
- 678. Hellmann, N. (1997). Vereinsbank wirkt wie die treibende Kraft. Frankfurt: Börsen-Zeitung, 22 July 1997.
- 679. Hermann, C. (1999). Eine Vielzahl von Sondereffekten prägt das Bankenjahr 1998; Verkaufserlöse und Steuereffekte "retten" die Jahresabschlüsse - Operative Ergebnisse enttäuschen - Die Zukunft wird optimistisch eingeschätzt. Frankfurt: Börsen-Zeitung, 10 April 1999.
- 680. Hosking, P. (1993). Change of style at Barclays. London: The Independent, 22 August 1993.
- 681. Ipsen, E (1995). Smith New Court Accepts Bid by Merrill Lynch. Paris: International Herald Tribune, 22 July 1995.
- 682. Jamieson, B. & Flanagan, M. (2002). RBoS is all fired up for further expansion. Edinburgh: The Scotsman, 1 March 2002.
- 683. Jenkins, P. (2003). Deutsche Bank close to giving up on stake in Gerling. London: Financial Times, 25 April 2003.
- 684. Jenkins, P. et al. (2005). UniCredito and HVB put faith in European integration. London: Financial Times, 14 June 2005.
- 685. Keers, H. (2004). Santander gives up Royal Bank seats. London: The Daily Telegraph, 13 November 2004.
- 686. Koehn, R. (1998). Die Erkenntnis einer konspirativen Autofahrt; Beteiligung der Deutschen Bank an der BV brachte die Fusion nach bayerischer Art in Gang. Frankfurt: Börsen-Zeitung, 28 August 1998.
- 687. Kroneck, S. (2003). Die Bank Austria kehrt auf das Börsenparkett zurück; HVB-Tochter und Konzernmutter geben sich selbstbewusst - Marktumfeld günstig - Erlös soll vor allem Kapitalbasis der HVB stärken. Frankfurt: Börsen-Zeitung, 21 June 2003.

- 688. Landau, P. (1989). Barclays: Europe is our home base. Jerusalem: The Jerusalem Post, 11 October 1989.
- 689. Lascelles, D. (1989). Deutsche Bank in 950m pound agreed bid for Morgan. London: Financial Times, 28 November 1989.
- 690. Lascelles, D. (1990). Citizens Financial suffers fall in net income. London: Financial Times, 4 December 1990.
- 691. Lascelles, D. (1990). Barclays to make Pounds 153m French bank acquisition. London: Financial Times, 29 December 1993.
- 692. Lewis, W. & Corrigan, T. (1998). Deutsche races to seal Bankers Trust deal: Discussions brought forward as details leak to markets. London: Financial Times, 23 November 1998.
- 693. Lewis, W. (1997). Flying Frank puts the trust back into Bankers Trust. London: Financial Times, 30 December 1997.
- 694. Linnell, I. (2000). Lloyds TSB: the only way is up. London: The Banker, 1 January 2000.
- 695. Mackintosh, J. (2000). Lloyds to launch European internet bank. London: Financial Times, 3 January 2000.
- 696. Mackintosh, J. (2000). Lloyds TSB signals strategy change. London: Financial Times, 12 February 2000.
- 697. Mackintosh, J. (2001). Barclays renews onslaught on rich. London: Financial Times, 22 May 2001.
- 698. Mackintosh, J. (2002). HSBC to integrate investment bank. London: Financial Times, 19 February 2002.
- 699. Major, T. & Hall, W. (2000). Crunch time for HVB/Bank Austria merger deal. London: Financial Times, 27 September 2000.
- 700. Major, T. (1999). Creditors disagree on Holzmann. London: Financial Times, 19 November 1999.
- 701. Major, T. (2000). HypoVereinsbank leaves its troubles in the last century. London: Financial Times, 22 February 2000.
- 702. Major, T. (2000). HypoVereinsbank raises stake. London: Financial Times, 12 May 2000.
- 703. Major, T. (2000). Courting couple may learn from others' heartache: Dresdner and Commerzbank wouldn't want a bitter break-up. London: Financial Times, 20 June 2000.
- 704. Major, T. (2001). HypoVereinsbank in revamp - mortgage finance bank to combine property lending operations in move to halt fall in profits. London: Financial Times, 6 February 2001.
- 705. Major, T. (2001). HVB prepares to raise Euros 15.6bn war chest. London: Financial Times, 23 May 2001.
- 706. Major, T. (2001). HVB steps up cost-cutting in retail banking. London: Financial Times, 18 July 2001.

707. Major, T. (2001). HVB set to cut 3,000 more jobs. London: Financial Times, 18 October 2001.
708. Major, T., Pretzlik, C. & Ratner, J. (2000). German banks in talks - Banking: Dresdner and Commerzbank meet today in latest consolidation move. London: Financial Times, 17 June 2000.
709. Major, T., Saigol, L. & Silverman, G. (2000). Dresdner Bank set to seal \$1.3bn purchase of Wasserstein Perella, London: Financial Times, 13 September 2000.
710. Marckus, M. & Goddway, N. (1991). Midland called to account - The woes of Midland Bank culminated on Tuesday with the departure of Sir Kit McMahon. London: The Observer, 10 March 1991.
711. Martinson, J (1997). CSFB to acquire Barclays divisions - Equity and corporate advisory businesses sold for GBP 50m less book value. London: Financial Times, 13 November 1997.
712. Millar, B. (1993). Royal close to selling offshoot. Edinburgh: The Scotsman, 30 January 1993.
713. Neue Zürcher Zeitung (1997). Verkauf der Creditanstalt an die Bank Austria; Zusammenschluss der zwei groessten Banken Österreichs. Zurich: Neue Zürcher Zeitung, 13 January 1997.
714. Nisse, J. (2001). Lloyds TSB courts Deutsche Bank. London: The Independent on Sunday, 25 November 2001.
715. Parkes, C. (1994). German bank takes over Swiss firm. London: Financial Times, 21 July 1994.
716. Pensions and Investments (2002). News Briefs; Ohio withdraws from federal class actions, files solo lawsuits against WorldCom, Enron. New York, NY: Pensions and Investments, 16 September 2002.
717. Peston, R. (1992). Midland rebuffed Lloyds' takeover advances. London: Financial Times, 19 March 1992.
718. Peterson, T. & Silverman, G. (1998). Is Deutsche bank "out of its depth"? New York, NY: Business Week, 7 December 1998.
719. Peterson, T. (1997). Dresdner Bank: who's in charge here? A switch of CEOs is under way, and key execs are fleeing as signs of turmoil grow. New York, NY: Business Week, 10 November 1997.
720. Plender, J. (1988). A threat to the golden goose. London: Financial Times, 29 October 1988.
721. Powell, R. (1998). Royal Bank sells stake in Newton for \$ 56m. Glasgow: The Herald, 25 July 1998.
722. Pretzlik, C. & Targett, S. (2000). Jupiter staff reap millions from sale to Commerzbank: Executives have been offered 1,000% of salary to stay with group. London: Financial Times, 3 June 2000.
723. Retail Banker International (1996). Back to the branch. Dublin: Research and Markets, 3 May 1996.

- 724. Retail Banker International (2003). HVB subsidiaries for sale. London: Retail Banker International, 14 January 2003.
- 725. Ringshaw, G. (2002). Is HSBC losing the plot? The investment banking arm of Britain's largest bank is getting stick over its strategy. London: Sunday Telegraph, 4 August 2002.
- 726. Ross, S. (2004). Much more than a call centre in a shed: The interview: First Direct's chief executive has a passion about customer relations. London: Financial Times, 27 March 2004.
- 727. Roth, M. (2000). Die Deutsche Bank präsentiert ein Rekordergebnis. Frankfurt: Frankfurter Allgemeine Zeitung, 4 August 2000.
- 728. Roth, M. (2000). Bankers Trust ist das letzte, was die Deutsche Bank braucht. Frankfurt: Frankfurter Allgemeine Zeitung, 31 October 2000.
- 729. Saigol, L. (2002). Dresdner Bank heads for shake-up. London: Financial Times, 24 April 2002.
- 730. Saigol, L. (2002). HSBC unperturbed by City whispers: The company says its commitment to investment banking is firm despite an exodus of senior staff. London: Financial Times, 21 May 2002.
- 731. Saigol, L. (2002). JP Morgan poaches top HSBC equities analysts. London: Financial Times, 29 April 2002.
- 732. Scherer, J. (1999). Die Zukunft ist endlich geregelt; ADIG/HYPO-INVEST / Die HypoVereinsbank verkauft ihre Anteile an der Fonds-Tochter Adig der Commerzbank. Munich: Börse Online, 4 March 1999.
- 733. Schmid, F. (2004). RBS to start lending through coffee shops. London: Financial Times. 25 June 2004.
- 734. Schneider, R. (1995). "Die Bank an Ihrer Seite" ging oft eigene Wege; 125 Jahre Commerzbank: Von Hamburg ueber Berlin, Düsseldorf nach Frankfurt und in die Welt. Frankfurt: Börsen-Zeitung, 17 February 1995.
- 735. Shearlock, P. (1997). Life after BZW for Barclays. London: The Banker. 1 December 1997.
- 736. Shearlock, P. (1999). Deutsche's gamble; Deutsche Bank's gutsy acquisition of Bankers Trust. London: The Banker, 1 January 1999.
- 737. Simonian, H. (1989). Deutsche Bank flirts with managing funds. London: Financial Times, 22 November 1989.
- 738. Simonian, H. (1993). Deutsche Bank looks to fill in the gaps - Chief executive Hilmar Kopper outlines his equities expansion plan. London: Financial Times, 16 September 1993.
- 739. Smith, A. (1995). C&G Members agree to Lloyds' takeover bid. London: Financial Times, 1 April 1995.
- 740. Smith, A. (1995). UK company news (LLOYDS/TSB) - Merger will extend beyond branding. London: Financial Times, 12 October 1995.
- 741. Smith, A. (1995). UK company news - Lloyds-TSB merger may cost

- GBP 300 million. London: Financial Times, 4 November 1995.
742. Smith, A. (1996). Restructuring provision hits Lloyds TSB. London: Financial Times, 17 February 1996.
743. Snoddy, J. (2001). Lloyds TSB rolls out euro e-bank. London: The Independent on Sunday, 7 October 2001.
744. Stuedemann, F. (1998). HypoVereinsbank lifts stake in Foreign & Colonial. London: Financial Times, 31 December 1998.
745. Süddeutsche Zeitung (1993). BV hat jetzt eine Enkeltochter in der Schweiz. Munich: Süddeutsche Zeitung, 17 February 1993.
746. Süddeutsche Zeitung (1993). Auch die Risiken am Horizont sind abgedeckt. Hypo-Bank bleibt auf Wachstums-Kurs / Unveränderte Dividende. Munich: Süddeutsche Zeitung, 24 March 1993.
747. Süddeutsche Zeitung (1993). Adig profitiert vom Luxemburg-Boom. Mittelzuflüsse der Fondsgesellschaft deutlich gestiegen. Munich: Süddeutsche Zeitung, 20 August 1993.
748. Süddeutsche Zeitung (1995). Bayerische Vereinsbank AG eröffnet weitere Filiale in Prag. Munich: Süddeutsche Zeitung, 20 February 1995.
749. Süddeutsche Zeitung (1995). Dresdner Bank will Kleinwort Benson kaufen. Munich: Süddeutsche Zeitung, 16 June 1995.
750. Süddeutsche Zeitung (1995). Dresdner Bank kauft US Gruppe RCM. Munich: Süddeutsche Zeitung, 16 December 1995.
751. Süddeutsche Zeitung (1996). Auch Dresdner Bank durchforstet ihre Filialen. Munich: Süddeutsche Zeitung, 2 April 1996.
752. Süddeutsche Zeitung (1996). Dresdner Bank startet nun auch Direktbank. Munich: Süddeutsche Zeitung, 2 November 1996.
753. Süddeutsche Zeitung (1997). Dresdner Bank verliert Kleinwort-Chef. Munich: Süddeutsche Zeitung, 3 March 1997.
754. Süddeutsche Zeitung (1997). Dresdner Bank gibt sich Aktionärsfreundlich. Munich: Süddeutsche Zeitung, 11 April 1997.
755. Süddeutsche Zeitung (1997). Bei der Adig steht die Scheidung an. Munich: Süddeutsche Zeitung, 17 June 1997.
756. Süddeutsche Zeitung (1997). Dresdner Bank blickt ins Ausland. Munich: Süddeutsche Zeitung, 30 July 1997.
757. Süddeutsche Zeitung (1997). Barclays gibt Investmentzweig auf. Munich: Süddeutsche Zeitung, 4 October 1997.
758. Süddeutsche Zeitung (1997). Dresdner Bank will unabhängig bleiben. Munich: Süddeutsche Zeitung, 31 October 1997.
759. Süddeutsche Zeitung (1998). Vereinsbank-Chef Albrecht Schmidt wird 60 Jahre. Munich: Süddeutsche Zeitung, 12 March 1998.

- 760. Süddeutsche Zeitung (1998). 'Die Dresdner Bank hat wieder Tritt gefaßt'. Munich: Süddeutsche Zeitung, 27 March 1998.
- 761. Süddeutsche Zeitung (1998). Dresdner Bank glänzt mit Rekordgewinn. Munich: Süddeutsche Zeitung, 29 Juli 1998.
- 762. Süddeutsche Zeitung (1998). HypoVereinsbank beteiligt sich an polnischer Bank. Munich: Süddeutsche Zeitung, 23 October 1998.
- 763. Süddeutsche Zeitung (1998). HypoVereinsbank kostet Bereinigung von Altlasten 3,5 Milliarden DM. Munich: Süddeutsche Zeitung, 29 October 1998.
- 764. Süddeutsche Zeitung (1998). Martini attackiert Chef der HypoVereinsbank. Munich: Süddeutsche Zeitung, 31 October 1998.
- 765. Süddeutsche Zeitung (1998). HypoVereinsbank - Die Mär von den Ahnungslosen. Munich: Süddeutsche Zeitung, 24 November 1998.
- 766. Süddeutsche Zeitung (2000). Dresdner Bank und BNP beenden Ost-Geschäft. Munich: Süddeutsche Zeitung, 23 December 2000.
- 767. Süddeutsche Zeitung (2000). HypoVereinsbank verkauft F&C an Eurok. Munich: Süddeutsche Zeitung, 23 December 2000.
- 768. Süddeutsche Zeitung (2001). Börsenflaute macht HypoVereinsbank zu schaffen. Munich: Süddeutsche Zeitung, 27 July 2001.
- 769. Süddeutsche Zeitung (2001). HypoVereinsbank bündelt Finanzierung. Munich: Süddeutsche Zeitung, 6 February 2001.
- 770. Süddeutsche Zeitung (2001). HypoVereinsbank mit Filialgeschäft unzufrieden. Munich: Süddeutsche Zeitung, 7 March 2001.
- 771. Süddeutsche Zeitung (2001). HypoVereinsbank hofft auf Synergieeffekte. Munich: Süddeutsche Zeitung, 18 July 2001.
- 772. Süddeutsche Zeitung (2001). Münchener Rück und HVB bauen Kooperation aus. Munich: Süddeutsche Zeitung, 20 December 2001.
- 773. Süddeutsche Zeitung (2003). Bank Austria stockt Beteiligung an BPH auf; HVB-Tochter bei Börsengang unter Erfolgsdruck / Höhere Marktanteile in Osteuropa. Munich: Süddeutsche Zeitung, 23 May 2003.
- 774. Süddeutsche Zeitung (2003). HypoVereinsbank schrumpft sich gesund. Munich: Süddeutsche Zeitung, 17 July 2003.
- 775. Targett, S. (2000). Hill Samuel to lose separate identity. London: Financial Times, 1 March 2000.
- 776. Tehan, P. (1996). HSBC to fuse Montagu and Capel operations. London: The Times, 30 January 1996.
- 777. The Banker (1999). Barclays searches for new chief. London: The Banker, 1 January 1999.
- 778. The Banker (1999). Lloyds TSB extends empire further with pounds 7 billion Scottish Widows acquisition. London: The Banker, 1 July 1999.

- 779. The Banker (2000). NatWest goes quietly. London: The Banker, 1 March 2000.
- 780. The Banker (2001). Barclays and L&G form alliance. London: The Banker, 1 February 2001.
- 781. The Banker (2002). Germany - German Banks Hang On To Retail - Recent Merger Talks Between Germany's Deutsche Bank and the UK's Lloyds TSB failed to cause a stir on the continent. London: The Banker, 1 May 2002.
- 782. The Economist (1981). Foreign banks in Spain - No trespassing. London: The Economist, 14 March 1981.
- 783. The Economist (1992). Barclays changes boss. London: The Economist, 25 April 1992.
- 784. The Economist (1992). Gloves off in British banking - Lloyds and HSBC Holdings battle for Midland. London: The Economist, 2 May 1992.
- 785. The Economist (1992). Lloyds Bank looks ahead after dropping bid for Midland. London: The Economist, 13 June 1992.
- 786. The Economist (1994). Lloyds Bank's latest buy. London: The Economist, 23 April 1994.
- 787. The Economist (1995). Retail banking - Lloyds Bank: The black horse goes to the vet. London: The Economist, 22 July 1995.
- 788. The Economist (1996). Learning how to lend: Technology is helping institutions to codify what they know about their business. London: The Economist, 26 October 1996.
- 789. The Economist (1997). Dresdner Bank - Lost leader. London: The Economist, 20 December 1997.
- 790. The Economist (1998). The Lloyds money machine. London: The Economist, 17 January 1998.
- 791. The Economist (1998). Investment banking - Barclays lite. London: The Economist, 7 February 1998.
- 792. The Economist (2000). Scot free? London: The Economist, 5 February 2000.
- 793. The Economist (2000). The next battle. London: The Economist, 12 February 2000.
- 794. The Economist (2000). English banking: What's the word - small? 13 May 2000.
- 795. The Economist (2000). A Bavarian botch-up. London: The Economist, 5 August 2000.
- 796. The Economist (2000) Barclays was once a leading world bank. It would like to be so again. London: The Economist, 18 November 2000.
- 797. The Economist (2000). Barclays' big ambitions. London: The Economist, 18 November 2000.

- 798. The Economist (2001). Lloyds TSB needs a new strategy, fast. London: The Economist, 14 July 2001.
- 799. The Economist (2002). For better, for worse - Allianz's trouble with Dresdner Bank. London: The Economist, 17 August 2002.
- 800. The Economist (2004). The world's piggybank. February 14, 2004.
- 801. The Independent (1996). Capel and Montagu merged. London: The Independent, 30 January 1996.
- 802. The Scotsman (1992). Success of Royal Bank of Scotland's Direct Line insurance. Edinburgh: The Scotsman, 6 October 1992.
- 803. The Wall Street Journal Europe (1995). Foreign Service: Bayerische Vereinsbank Continues Expansion. London: The Wall Street Journal Europe, 14 November 1995.
- 804. Thomson, R. (1988). Royal Bank of Scotland in 79 million pounds Spanish link-up; Banco Santander. London: The Times, 4 October 1988.
- 805. Thomson, R. (1988). US bank bid agreed by Royal. London: The Times, 29 April 1988.
- 806. Tighe, C. (2000) Barclays' risky retreat from the country. London: Financial Times, 8 April 2000.
- 807. Time Magazine (1971). Better Than Marriage. New York, NY: Time Magazine, 1 February 1971.
- 808. Timmons, H. (2004). HSBC builds investment banking role. Neuilly-sur-Seine: The International Herald Tribune, 3 November 2004.
- 809. Treanor, J. (2000). NatWest surrenders today; Shareholders line up to support Royal Bank of Scotland takeover bid. London: The Guardian, 10 February 2000.
- 810. Treanor, J. (2000). Big boss, big fees and big trouble; Interview John Varley, head of retail financial services, Barclays. London: The Guardian, 8 April 2000.
- 811. Treanor, J. (2004). Great escape - Mehmet Dalman, founder of WMG. London: The Guardian, 2 October 2004.
- 812. Turpin, A. (1999). RBoS set to offload Trust Bank. Edinburgh: The Scotsman, 22 February 1999.
- 813. VWD (2001). Analysten: Verbindung Deutsche Bank/Lloyds unwahrscheinlich. Frankfurt: vwd - Vereinigte Wirtschaftsdienste, 26 November 2001.
- 814. VWD (2000). Dresdner Bank lässt Fusion mit Deutscher Bank platzen. Frankfurt: vwd - Vereinigte Wirtschaftsdienste, 5 April 2000.
- 815. Waller, D. (1992). Deutsche Bank acquires 30% stake in Gerling. London: Financial Times, 11 July 1992.
- 816. Waller, D. (1994). Dresdner Bank forms research unit. London:

Financial Times, 14 March 1994.

817. Waples, J. (2006). How committed is HSBC to investment banking?
London: Sunday Times, 19 February 2006.
818. Waters, R. (1994). Go West! Echoes in Barclays' ears. London:
Financial Times, 10 November 1994.
819. Willcock, J. (1991). Midland's new chief says the recession is the worst
seen in his banking career - In a Guardian interview, Brian Pearse tells
how the Bank of England plucked him from Barclays boardroom.
London: The Guardian, 25 March 1991.
820. Willcock, J. (1994). Royal Bank and Newton to form new pounds 8bn
fund. London: The Independent, 17 September 1994.
821. Willman, J. (2000). Dresdner Bank set to axe 5,000 jobs in shake-up.
London: Financial Times, 19 May 2000.
822. Willman, J. (2000). Barclays to spend GBP 325 million on e-commerce,
London: Financial Times, 24 May 2000.
823. Willman, J. (2000). Barclays' bid for Woolwich to cost GBP 30 million.
London: Financial Times, 6 September 2000.
824. Willman, J. (2000). Barrett sees plenty of upside after a year in the hot
seat. London: Financial Times, 20 September 2000.
825. Willman, J. (2001). Size isn't everything for bank virility measure -
Lloyds TSB has surprised the world of banking. London: Financial
Times, 6 February 2001.
826. Wittkowski, B. (1997). Commerzbank forciert globales Aktiengeschäft;
Ehrgeizige Ziele im Investmentbanking - Günstige Akquisitionschancen
sollen genutzt werde. Börsen-Zeitung, 11 October 1997.

E) Publications by banks and companies

- 827. Allianz (2001). Allianz and Dresdner Bank present takeover bid and new joint strategy. Munich: Allianz, 31 March 2001.
- 828. Allianz (2001). Annual Report 2001. Munich: Allianz.
- 829. Allianz (2001). Presentation: Allianz Group and Dresdner Bank. London: Allianz, 3 April 2001.
- 830. Allianz (2003). Annual Report on Form 20-F. Munich: Allianz.
- 831. Allianz (2003). 3+One. Available from:
<http://www.allianzgroup.com/azgrp/dp/cda/0,,189772-44,00.html>
[Accessed 27 March 2005].
- 832. Barclays. Annual Report 1990. London: Barclays.
- 833. Barclays. Annual Report 1991. London: Barclays.
- 834. Barclays. Annual Report 1992. London: Barclays.
- 835. Barclays. Annual Report 1993. London: Barclays.
- 836. Barclays. Annual Report 1994. London: Barclays.
- 837. Barclays. Annual Report 1995. London: Barclays.
- 838. Barclays. Annual Report 1996. London: Barclays.
- 839. Barclays. Annual Report 1997. London: Barclays.
- 840. Barclays. Annual Report 1998. London: Barclays.
- 841. Barclays. Annual Report 1999. London: Barclays.
- 842. Barclays. Annual Report 2000. London: Barclays.
- 843. Barclays (2000). Presentation: Recommended offer by Barclays for Woolwich. London: Barclays, 11 August 2000.
- 844. Barclays. Annual Report 2001. London: Barclays.
- 845. Barclays. Annual Report 2002. London: Barclays.
- 846. Barclays. Annual Report 2003. London: Barclays.
- 847. Barclays (2003). News Release - Barclays PLC announces proposed acquisition of Banco Zaragozano. London: Barclays, 8 May 2003.
- 848. Barclays. Annual Report 2004. London: Barclays.
- 849. Barclays (2004). Barclays' Investor Relations homepage [online]. London: Barclays. Available from:
<http://www.investorrelations.barclays.co.uk> [Accessed 16 July 2004].
- 850. Barclays (2004). Presentation: Barclays 2003 Preliminary Results. London: Barclays, 12 February 2004.
- 851. Barclays. Annual Report 2005. London: Barclays.

852. Bayerische Hypotheken-und Wechsel-Bank Aktiengesellschaft (1996). Mitteilung gemäß Paragraph 15 WpHG übermittelt von der DGAP (ots-ADHOC-Service) - Konzernbetriebsergebnis der HYPO-BANK knapp 10% höher. Munich: Bayerische Hypotheken-und Wechsel-Bank Aktiengesellschaft, 14 November 1996.
853. Bayerische Vereinsbank. Annual Report 1992. Munich: Bayerische Vereinsbank.
854. Bayerische Vereinsbank. Annual Report 1993. Munich: Bayerische Vereinsbank.
855. Bayerische Vereinsbank. Annual Report 1994. Munich: Bayerische Vereinsbank.
856. Bayerische Vereinsbank. Annual Report 1995. Munich: Bayerische Vereinsbank.
857. Bayerische Vereinsbank. Annual Report 1996. Munich: Bayerische Vereinsbank.
858. Bayerische Vereinsbank. Annual Report 1997. Munich: Bayerische Vereinsbank.
859. Bayerische Vereinsbank (1997). Mitteilung gemäß Paragraph 15 WpHG übermittelt von der DGAP (ots-ADHOC-Service) - Vereinsbank übernimmt Noris Verbraucherbank von Schickedanz-Gruppe. Munich: Bayerische Vereinsbank, 18 June 1997.
860. Comdirect. Annual Report 2001. Quickborn: Comdirect.
861. Commerzbank (1970). 100 Jahre Commerzbank. Düsseldorf: Commerzbank.
862. Commerzbank. Annual Report 1990. Frankfurt: Commerzbank.
863. Commerzbank. Annual Report 1991. Frankfurt: Commerzbank.
864. Commerzbank. Annual Report 1992. Frankfurt: Commerzbank.
865. Commerzbank. Annual Report 1993. Frankfurt: Commerzbank.
866. Commerzbank. Annual Report 1994. Frankfurt: Commerzbank.
867. Commerzbank. Annual Report 1995. Frankfurt: Commerzbank.
868. Commerzbank. Annual Report 1996. Frankfurt: Commerzbank.
869. Commerzbank. Annual Report 1997. Frankfurt: Commerzbank.
870. Commerzbank. Annual Report 1998. Frankfurt: Commerzbank.
871. Commerzbank. Annual Report 1999. Frankfurt: Commerzbank.
872. Commerzbank. Annual Report 2000. Frankfurt: Commerzbank.
873. Commerzbank. Annual Report 2001. Frankfurt: Commerzbank.
874. Commerzbank (2001). Presentation - Merger of the property and public

sector financing activities of Commerzbank, Deutsche Bank, Dresdner Bank to form the new Eurohypo AG. Frankfurt: Commerzbank, 6 November 2001.

875. Commerzbank. Annual Report 2002. Frankfurt: Commerzbank.
876. Commerzbank. Annual Report 2003. Frankfurt: Commerzbank.
877. Commerzbank. Annual Report 2004. Frankfurt: Commerzbank.
878. Commerzbank (2005). 135-Year History. Frankfurt: Commerzbank.
879. Commerzbank (undated a). Mercury's wings and the four winds - Commerzbank logos past and present [online]. Frankfurt: Commerzbank. Available from: https://www.commerzbank.com/konzern/geschichte/download/cb_logo_en.pdf [Accessed 27 January 2007].
880. Daviet, J.-P. & Germain, M. (1994). *Crédit Commercial de France: Une Banque dans le Siècle*. Paris: Crédit Commercial de France.
881. Deutsche Bank (2002). Share buy-back program launched. Frankfurt: Deutsche Bank, Press Release, 26 June 2002.
882. Deutsche Bank (undated). Deutsche Bank Milestones [online]. Frankfurt: Deutsche Bank. Available from: http://www.deutsche-bank.de/geschichte/en/html/index_m.htm [Accessed 17 December 2004].
883. Deutsche Bank. Annual Report 1993. Frankfurt: Deutsche Bank.
884. Deutsche Bank. Annual Report 1994. Frankfurt: Deutsche Bank.
885. Deutsche Bank. Annual Report 1995. Frankfurt: Deutsche Bank.
886. Deutsche Bank. Annual Report 1996. Frankfurt: Deutsche Bank.
887. Deutsche Bank. Annual Report 1997. Frankfurt: Deutsche Bank.
888. Deutsche Bank. Annual Report 1998. Frankfurt: Deutsche Bank.
889. Deutsche Bank. Annual Report 1999. Frankfurt: Deutsche Bank.
890. Deutsche Bank. Annual Report 2000. Frankfurt: Deutsche Bank.
891. Deutsche Bank. Annual Report 2001. Frankfurt: Deutsche Bank.
892. Deutsche Bank. Annual Report 2002. Frankfurt: Deutsche Bank.
893. Deutsche Bank. Annual Report 2003. Frankfurt: Deutsche Bank.
894. Deutsche Bank. Annual Report 2004. Frankfurt: Deutsche Bank.
895. Deutsche Bank. Annual Report 2005. Frankfurt: Deutsche Bank.
896. Deutscher Sparkassen- und Giroverband (2000). *Englischsprachige Fassung der Stellungnahme des DSGV zu der gegen Anstaltslast und Gewährträgerhaftung in Deutschland gerichteten Beihilfenbeschwerde der Europäischen Bankenvereinigung*. Berlin: Deutscher Sparkassen-

und Giroverband.

897. Dresdner Bank. Annual Report 1992. Frankfurt: Dresdner Bank.
898. Dresdner Bank. Annual Report 1993. Frankfurt: Dresdner Bank.
899. Dresdner Bank. Annual Report 1994. Frankfurt: Dresdner Bank.
900. Dresdner Bank. Annual Report 1995. Frankfurt: Dresdner Bank.
901. Dresdner Bank. Annual Report 1996. Frankfurt: Dresdner Bank.
902. Dresdner Bank. Annual Report 1997. Frankfurt: Dresdner Bank.
903. Dresdner Bank. Annual Report 1998. Frankfurt: Dresdner Bank.
904. Dresdner Bank. Annual Report 1999. Frankfurt: Dresdner Bank.
905. Dresdner Bank. Annual Report 2000. Frankfurt: Dresdner Bank.
906. Dresdner Bank. Annual Report 2001. Frankfurt: Dresdner Bank.
907. Dresdner Bank. Annual Report 2002. Frankfurt: Dresdner Bank.
908. Dresdner Bank. Annual Report 2003. Frankfurt: Dresdner Bank.
909. Dresdner Bank. Annual Report 2004. Frankfurt: Dresdner Bank.
910. Dresdner Bank (undated a). Die Dresdner Bank: Historischer Ueberblick [online]. Frankfurt: Dresdner Bank. Available from: http://www.dresdner-bank.com/meta/kontakt/03_dresdner_bank/03_historie/dresdner_bank_historisch.pdf [Accessed 4 December 2006].
911. Dresdner Bank (undated b). Dresdner Bank: History / Timeline [online]. Frankfurt: Dresdner Bank. Available from: http://www.dresdner-bank.com/content/03_unternehmen/01_zahlen_fakten/02_historie/02_z_eitleiste/1972_bis_1989.html [Accessed 7 January 2007].
912. Dresdner Bank (ed.) (1969). Aus der Geschichte der Dresdner Bank 1872-1969. Frankfurt: Fritz Knapp.
913. Evolvebank (2005). Evolvebank [online]. London: Evolvebank. Available from: <http://www.evolvebank.com> [Accessed 1 April 2005].
914. HSBC Holdings. Annual Report 1992. London: HSBC Holdings.
915. HSBC Holdings. Annual Report 1993. London: HSBC Holdings.
916. HSBC Holdings. Annual Report 1994. London: HSBC Holdings.
917. HSBC Holdings. Annual Report 1995. London: HSBC Holdings.
918. HSBC Holdings. Annual Report 1996. London: HSBC Holdings.
919. HSBC Holdings. Annual Report 1997. London: HSBC Holdings.
920. HSBC Holdings. Annual Report 1998. London: HSBC Holdings.
921. HSBC Holdings. Annual Report 1999. London: HSBC Holdings.

- 922. HSBC Holdings. Annual Report 2000. London: HSBC Holdings.
- 923. HSBC Holdings. Annual Report 2001. London: HSBC Holdings.
- 924. HSBC Holdings. Annual Report 2002. London: HSBC Holdings.
- 925. HSBC Holdings (2003a). Annual Report 2003. London: HSBC Holdings.
- 926. HSBC Holdings. Annual Report 2004. London: HSBC Holdings.
- 927. HSBC Holdings (2003b). Presentation - 2003 Annual Results. London: HSBC Holdings.
- 928. HSBC Holdings (2003c). The HSBC Group - A brief history. London: HSBC Holdings.
- 929. HVB. Annual Report 1998. Munich: HVB.
- 930. HVB. Annual Report 1999. Munich: HVB.
- 931. HVB (2000a). Annual Report 2000. Munich: HVB.
- 932. HVB (2000b). Retail Banking Conference - 19 October 2000. Munich: HVB Group.
- 933. HVB. Annual Report 2001. Munich: HVB Group.
- 934. HVB. Annual Report 2002. Munich: HVB Group.
- 935. HVB. Annual Report 2003. Munich: HVB Group.
- 936. HVB (undated). Hypovereinsbank Geschichte [online]: Available from: <http://geschichte.hypovereinsbank.de/> [Accessed 20 December 2006].
- 937. HypoVereinsbank (2001). Ad hoc: Bay. Hypo- u. Vereinsbank. Munich: HypoVereinsbank, 12 June 2001.
- 938. ING Group (2006). 12th Investor Relations Symposium - ING Direct Moving Forward. London: 27 September 2006.
- 939. Lloyds Bank. Annual Report 1990. London: Lloyds Bank.
- 940. Lloyds Bank. Annual Report 1991. London: Lloyds Bank.
- 941. Lloyds Bank. Annual Report 1992. London: Lloyds Bank.
- 942. Lloyds Bank. Annual Report 1993. London: Lloyds Bank.
- 943. Lloyds Bank. Annual Report 1994. London: Lloyds Bank.
- 944. Lloyds Bank. Annual Report 1995. London: Lloyds Bank.
- 945. Lloyds TSB. Annual Report 1996. London: Lloyds TSB.
- 946. Lloyds TSB. Annual Report 1997. London: Lloyds TSB.
- 947. Lloyds TSB. Annual Report 1998. London: Lloyds TSB.
- 948. Lloyds TSB. Annual Report 1999. London: Lloyds TSB.
- 949. Lloyds TSB. Annual Report 2000. London: Lloyds TSB.

950. Lloyds TSB. Annual Report 2001. London: Lloyds TSB.
951. Lloyds TSB. Annual Report 2002. London: Lloyds TSB.
952. Lloyds TSB. Annual Report 2003. London: Lloyds TSB.
953. Lloyds TSB (2005). Lloyds TSB Group History [online]. London: Lloyds TSB. Available from:
<http://www.investorrelations.lloydstsb.com/gr/history.asp> [Accessed 12 April 2005].
954. Lloyds TSB Presentation (1999). Scottish Widows to join Lloyds TSB Group - Presentation by Peter Ellwood, Group Chief Executive Lloyds TSB & Mike Ross, Group Chief Executive Scottish Widows. London: 23 June 1999.
955. Lloyds TSB Presentation (2003). BNP Paribas European Equities UK Banks Forum - Presentation by Michael Oliver, Director of Investor Relations Lloyds TSB Group. Madrid: 5 November 2003.
956. Royal Bank of Scotland Group - Announcement (2001). The Royal Bank of Scotland Group's US subsidiary to acquire regional banking business of Mellon Financial Corporation for \$2.1 billion. Edinburgh: Royal Bank of Scotland, 17 July 2001.
957. Royal Bank of Scotland Group (1998). The Royal Bank of Scotland: A History. Edinburgh: Royal Bank of Scotland.
958. Royal Bank of Scotland Group (2000). Retail Banking Conference - 19 October 2000. Edinburgh: Royal Bank of Scotland.
959. Royal Bank of Scotland Group. Presentation - 2003 Annual Results. Edinburgh: Royal Bank of Scotland.
960. Royal Bank of Scotland Group (2005). A short history of The Royal Bank of Scotland. Edinburgh: Royal Bank of Scotland.
961. Royal Bank of Scotland Group (undated). Royal Bank of Scotland: About us [online]. London: Royal Bank of Scotland. Available from:
http://www.rbs.com/about01.asp?id=ABOUT_US [Accessed 17 June 2006].
962. Royal Bank of Scotland Group. Annual Report 1992. Edinburgh: Royal Bank of Scotland.
963. Royal Bank of Scotland Group. Annual Report 1993. Edinburgh: Royal Bank of Scotland.
964. Royal Bank of Scotland Group. Annual Report 1994. Edinburgh: Royal Bank of Scotland.
965. Royal Bank of Scotland Group. Annual Report 1995. Edinburgh: Royal Bank of Scotland.
966. Royal Bank of Scotland Group. Annual Report 1996. Edinburgh: Royal Bank of Scotland.
967. Royal Bank of Scotland Group. Annual Report 1997. Edinburgh: Royal

Freiburg, 11 March 2002. Available from: www.walter-eucken-institut.de/veranstaltungen.htm#frueherevortraege [Accessed 11 November 2002].

1019. Solans E.D. (2002). European financial integration and stability. Speech delivered at the conference organised by the Association of Foreign Bank Representatives in Germany, Frankfurt am Main, 17 September 2002.
1020. Van Miert, K. (1998). EU Competition Policy in the Banking Sector. Speech by EU Commissioner Van Miert to the foreign bankers in the Belgian Bankers' Association, Brussels, 22 September 1998.
1021. Weber, M. (2003). Presentation: Bankenstandort Deutschland. 30 Oktober 2003, Zurich: Bundesverbandes deutscher Banken.